The Influence of Culture and Politics on Accounting Change in India from 1947 to 1998

Volumes 1 and 2

by

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Abstract

The exploratory research in this thesis analyses the influence of culture and politics on accounting change since independence. A theoretical framework is proposed within which historical studies of the influence of culture and politics on accounting and accounting change may be undertaken. In this framework, the accounting system is viewed as part of the whole social system in the country of study, providing information for decision making and providing a tool for economic and social development. Culture affects all the social systems in the country, including the accounting system and the outcome of the process for accounting change is affected by political processes.

Using the framework, accounting changes in India are broken down into three phases, a source phase, a diffusion phase and a reaction phase. In the source phase, change to the accounting system is set in motion, usually from outside the accounting system. The diffusion phase of any change looks at how change is dispersed and accommodated within the system and the reaction phase of any accounting change looks at how the accounting system is modified subsequent to the diffusion phase. The diffusion phase and the reaction phase encompass both intra-system activity, activity between the different components of the accounting system and trans-system activity, activity between the accounting system and its neighbouring systems and both types of activity determine the outcome of any change.

The framework is used to analyse key changes to the accounting system in India from independence in 1947 through to 1998. The source of accounting change is usually seen to come from outside the accounting system in India and relates mainly to the social and economic development of India. In both the diffusion and reaction phases, intra-system activity takes place between the main regulatory authorities within the accounting system which are identified to be government institutions and professional accounting institutes. Trans-system activity too takes place in both the diffusion and reaction phases and the main social systems influencing the accounting system are identified to be the economic system, the political system, the tax system, the financial system, the corporate system and the international system. Culture, both nation-specific cultural values such as hierarchy and collectivism and universal cultural values of high power distance, low individualism, low uncertainty avoidance and high masculinity, affect all social systems and all three phases of the change.

Culture is seen to influence the accounting system and accounting change in India with strong Government involvement in accounting, the extensive use of statutory legislation to promulgate accounting change, accounting regulated by both statutory legislation and an accounting profession and accounting change initiated for social and economic reasons. In addition, the accounting values seen in the Indian accounting system are uniformity, secrecy with some transparency

and conservatism with some optimism, which are as expected, based on the cultural values of India. The process of accounting change is seen to be political with government involvement in accounting, accounting regulations promulgated through the parliamentary system and accounting change being the outcome of interactions, both formal and informal, between the main parties interested in accounting, identified to be government regulatory institutions, professional accounting institutes, the corporate sector and parliament. The theoretical framework is shown to be helpful in the analysis of both culture and politics on accounting change in India.

Key abbreviations

Bombay Stock Exchange	BSE
Central Bureau of Direct Taxes	CBDT
Controller of Capital Issues	CCI
Department of Company Affairs	DCA
Foreign Exchange Regulation Act	FERA
Indian Accountancy Board	IAB
Indian Administrative Service	IAS
Indian National Congress	INC
Institute of Chartered Accountants in England and Wales	ICAEW
Institute of Chartered Accountants of India	ICAI
Institute of Company Secretaries of India	ICSI
Institute of Cost and Works Accountants of India	ICWAI
Monopolies and Restrictive Trade Practices Act	MRTP
National Stock Exchange	NSE
Securities and Exchange Board of India	SEBI

Chapter 1

Introduction

Culture and politics have been identified in the literature as important factors influencing accounting systems and the process of accounting change. This thesis proposes a theoretical framework within which the influence of culture and politics on accounting change may be studied and, using this framework, the influence of culture and politics on the main changes to the accounting system in India from independence to 1998 are examined. Both culture and politics and the theoretical framework are discussed below.

Culture and accounting

Recent research in international accounting has identified culture as an important influence on accounting and on the process of accounting change. *(Gray 1988; McKinnon 1986; Meek and Sundgaran, 1990).* Culture has been defined in the anthropological and sociological literature and a generally accepted definition of culture has been provided by Kroeber and Kluckhohn as follows:

> *" Culture consists of patterns, explicit and implicit, of and for behaviour acquired and transmitted by symbols, constituting the distinctive achievements of human groups, including their embodiments in artefacts; the essential core of culture consists of traditional (i.e. historically derived and selected) ideas and especially their attached values; Cultural systems may on one hand be considered as products of action, on the other as conditioning elements of further action."*
>
> *(Kroeber A.L., and Kluckhohn C., 1952, p181)*

Culture is learned or acquired behaviour resulting from man's response to his environment which, once acquired, then conditions man's response to his social environment. The accounting system is viewed as a social system in the country

fulfilling the social function of providing financial information for decision making by individual, corporate and national entities and providing an important tool for economic and social management. *(Burchell, Clubb and Hopwood, 1985; McKinnon, 1986).* As such, culture affects all systems and processes in a country, including the accounting system. The development of accounting, like any social process, is affected by national culture and the institutional environment since "culture influences:

a the norms and values of such systems

b the behaviour of groups in their interactions within and across the system"

(Harrison G. and McKinnon J.L., 1986, page 239)

The influence of culture on accounting has been studied within international accounting, mainly since the 1980's *(Violet 1983; Bloom and Naciri, 1989; Belkaoui 1989).* In 1986, McKinnon undertook an in-depth historical study of the influence of culture on accounting change in Japan and proposed a framework for historical studies of accounting change. Gray, in 1988, proposed a theoretical framework, based on the work of Hofstede, which linked culture and accounting and within which the impact of culture and accounting could be studied. Some tests, mainly cross sectional analyses, of Gray's framework have been undertaken. *(Salter and Niswander, 1995; Salter and Doupnik, 1992; Zarsekei, 1996).* However, more research on culture and accounting is needed, both cross sectional studies of culture and accounting and in depth historical studies of the influence of culture on accounting in single countries. *(Previts, 1975; Schoenfield, 1981; McKinnon, 1986; Gray, 1989; Wallace and Gernon, 1991)*

There have been some historical studies of accounting systems, accounting change and key accountants in different countries but these have focused mainly on western, anglo-saxon countries. *(Zeff, 1972, 1978; Parker, 1989; Carnegie and Parker, 1999).* There have been only a few in-depth studies of culture and accounting on non-western, non-anglo saxon countries, for example by McKinnon, in 1986 who studied accounting change in Japan. There has however, been little in-depth historical research into the influence of culture on

accounting change in developing countries and these have been identified as an important and necessary addition to the research that has been done on western accounting systems. *(Previts, 1975; Schoenfield, 1981; McKinnon, 1986; Gray, 1989; Wallace and Gernon, 1991)*

Politics and accounting

In addition to culture, politics too has been identified as an important influence on the process of accounting change. *(Zeff 1972, 1978; Watts and Zimmerman, 1978, 1985; Burchell, Clubb and Hopwood, 1985).*

Accounting change is seen to be political in three main senses:

- accounting change is influenced by Government
- accounting changes are promulgated using the parliamentary system
- accounting change is the result of negotiations between different parties interested and involved in accounting

There have been two broad approaches to the study of politics and accounting, positive accounting theory as proposed by Watts and Zimmerman and an approach which focuses on social interactions as proposed by Burchell et al. *(Watts and Zimmerman, 1978, 1985; Burchell, Clubb and Hopwood, 1985).*

These two approaches to the study of influence of politics on accounting are very different. However, most of the research done using both approaches has been on western, anglo-saxon countries and it would be useful to add some research which analyses the influence of politics and political processes on accounting and on accounting change in different countries with different environments.

Reasons for the Study

As outlined above, culture and politics have been identified as important influences on accounting and accounting change and as needing further study and investigation. In addition to cross sectional research and historical research on anglo-saxon, western countries, historical research into non- western and non-anglo saxon countries is also needed. *(McKinnon, 1986; Gray, 1988, 1989; Previts, 1985; Schoenfeld, 1981)*

In this research, a historical analysis of the influence of culture and politics on accounting change in India is undertaken. The research investigates changes to the main institutions within the accounting system, the interactions between these institutions, the process of accounting change and the actual operation of the accounting system, and not just changes to technical accounting regulations.

India is chosen for study as it is an important developing country. India is the largest democracy in the world and is seen as a leader amongst the developing world. India has undergone many political regimes from a mixed economy in the 1950's to liberalisation in the 1990's and hence a study of India is expected to provide useful insights into the influence of politics on accounting. In addition, until 1947, India was colonised by Britain and had little or no choice in the systems implemented in its country, including the accounting system. After independence, India developed its own systems, including developing its accounting system and hence a study of the development of the accounting system after independence is expected to provide useful insights into the influence of culture and the social context on accounting in India. Finally, in the 1990's, India became a board member of the International Accounting Standards Committee (IASC) and hence became a more important country from an international accounting point of view.

There has been very little research on accounting in India. Some research on disclosure practices in India has been carried out, for example by Singhvi and Desai *(1971)*, Marston *(1986)* and Das Gupta *(1986)*. There has also been a study

on the changes to the Companies Acts 1913, 1936 and 1956 by Chakravorty *(1994)*. However, there has been no detailed historical study on accounting change since independence and no in-depth study on the influence of culture and politics on accounting change in India.

The research in this thesis aims to make an original contribution to the literature by providing an in-depth study of the influence of culture and politics on accounting change in India from independence in 1947 to 1998. The influence of culture and politics on accounting change is studied by identifying the main changes to accounting institutions, regulations and processes in the accounting system in India since independence and analysing these changes using the framework outlined below.

Methodology

The theoretical framework proposed in this thesis is based on the work of McKinnon *(1986)* and Gray *(1986)* and is expected to facilitate the analysis of culture and politics on the process of accounting change within historical studies of accounting change.

In this exploratory framework, the accounting system is viewed as part of the whole social system in the country of study, which includes the authorities which formulate regulations, the institutional environment within the system, and interactions among all the different parts of the system. Culture affects all the social systems in the country, including the accounting system.

Key accounting changes are identified and, using the framework, each accounting change is broken down into three phases, a source phase, a diffusion phase and a reaction phase. In the source phase, change to the accounting system is set in motion. The source phase is expected to consist of exogenous events, events arising from outside the accounting system, such as war, colonisation and international factors, which disrupt the accounting system and lead

to changes in the institutions of the accounting system and changes to the accounting regulations.

The diffusion phase of any change looks at how change is dispersed and accommodated within the system and the reaction phase of any accounting change looks at how the accounting system is modified subsequent to the diffusion phase and how the change is finally incorporated into the accounting system. The diffusion phase and the reaction phase encompass both intra-system activity (activity between the different components of the accounting system) and trans-system activity (activity between the accounting system and its neighbouring systems) and both types of activity will determine the outcome of any change. Intra-system activity is expected to take place between the main regulatory authorities within the accounting system, which, in India, are expected to be governmental institutions and the professional accounting bodies. Trans-system activity in India is expected to take place between the economic system, the political system, the tax system, the financial system, the corporate system and the international system and the accounting system.

The culture of the country affects all social systems and all three phases of the change described above. It is expected that both nation-specific cultural values and universal culture values will be important in the analysis of accounting change, affecting both accounting values and the accounting system. Culture is not treated as a single separate factor that affects accounting in isolation; instead it is viewed as affecting all the systems in the country, the accounting system and the systems neighbouring the accounting system. In addition, the outcome of accounting change is expected to be influenced by the interactions between the different parties interested in accounting and also influenced by the Government.

The main changes to the accounting system in India are identified to be the promulgation of the Companies Act 1956 and changes to this Act, the setting up of the accounting profession in India, the initiation of key regulatory processes by the accounting profession and the influence of taxation on accounting. These changes are analysed using the theoretical framework described above.

Data for the research is obtained from

- literature on India,
- a survey of accounts of key companies for the year ended in 1996
- a survey of accounts for some companies from the 1940's and 1950's
- an analysis of "The Chartered Accountant" , the journal of the Institute of Chartered Accountants of India published in India
- a review of key parliamentary reports and parliamentary debates on changes to the accounting system involving legislation
- interviews with the main parties interested and involved in accounting in India

The data is used to both identify the main changes to the accounting system since independence and to analyse the influence of culture and politics on the accounting changes chosen for study.

Contributions of the research

There are two main contributions of the research in this thesis. Firstly, a theoretical framework is proposed within which historical studies of accounting change may be undertaken and which is expected to facilitate the study of culture and politics on accounting change. This exploratory framework is used to analyse accounting change and the advantages and problems associated with the framework are assessed to see whether it does, in practice, facilitate the investigation of accounting change in single countries.

Secondly, the thesis provides a historical study of the influence of culture and politics on accounting change in a key developing country, which has not been studied in-depth before. Culture and politics have been identified as important influences on accounting change which need further investigation. In addition,

there has been little in-depth, historical research on non-anglo saxon, non-western countries and the research in this thesis provides one such study.

Chapter outline

Chapter 2 reviews the literature on culture and accounting, politics and accounting, and accounting in India. Both culture and politics are identified as important influences on accounting and the process of accounting change. The frameworks of Gray *(1988)* and McKinnon *(1986)* for studying culture and accounting are also detailed.

Chapter 3 details the methodology used in the thesis, both the proposed theoretical framework, based on the work of Gray *(1988)* and McKinnon *(1986)*, and the sources of data used. The chapter includes an assessment of the limitations and constraints of the research.

Chapter 4 discusses the main cultural and social values in India, outlines the main economic and political institutions that are expected to influence accounting in India and traces the development of the social, political and economic context of India since independence. Chapter 5 goes on to discuss the accounting values in India, which are influenced by the cultural values discussed in chapter 4. The chapter also discusses the development of the accounting system in India, identifying the main changes to be analysed in the thesis. Both these chapters provide information which is used in the detailed analysis of the accounting changes provided in chapters 6 to 13.

The most important accounting regulations in India are contained in the Companies Act 1956 and this is analysed in Chapters 6 to 9. Chapter 6 analyses the promulgation of the Companies Act 1956 itself. Chapters 7 and 8 analyse the promulgation of the Companies (Amendment) Bill 1974 and the promulgation of the Companies (Amendment) Bill 1988, the two most important changes to the Companies Act since its promulgation in 1956. Chapter 9 analyses the attempt to

rewrite the Companies Act 1956, in the 1990's, via the Companies Bill 1997, which was still incomplete at the end of 1998.

As well as strong statutory legislation, the accounting profession is also important in India and chapters 10, 11 and 12 analyse the accounting profession in India. Chapter 10 analyses the setting up, in 1949, of the Institute of Chartered Accountants of India (ICAI), the professional accounting institute which regulates financial reporting and auditing in India. Chapter 11 analyses the standard setting process of the ICAI, initiated in 1977 to regulate financial reporting. Chapter 12 analyses the setting up, in 1959, of the Institute of Cost and Works Accountants of India (ICWAI) to regulate cost accounting.

Chapter 13 looks at more recent changes and the influence of taxation on accounting in India. This has been an important influence on accounting in India and has led to two practices not seen in most other countries, the tax audit and the tax authorities promulgating accounting standards.

Chapter 14 summarises the main conclusions of the research. Accounting change is shown to be influenced by both cultural values and political processes and the framework proposed in the thesis is shown to be helpful in analysing the influence of culture and politics on accounting change in India. The chapter also contains an assessment of the advantages and problems with the proposed framework and discusses further work that needs to be undertaken.

Chapter 2

Literature review

Introduction

The study of differences in accounting systems of different countries has been investigated by many international accounting authors since the 1960's when it was first accepted that international accounting was a valid area for university study and academic research. Authors such as Mueller *(1965)*, Kollaritsch *(1965)* and Seidler *(1967)* all argued for the importance of international accounting, both as a valuable research area and as an important subject for teaching at university level. They argued that international accounting was not only an important research area in its own right, looking at transnational issues and multinational enterprises, but also important in giving an opportunity to develop domestic research by providing a "laboratory" for the analysis of national accounting issues. Thus, international accounting with its study of accounting in different countries would be valuable, not only for increasing knowledge of international accounting, but as directly relevant for increasing knowledge about domestic issues. Once international accounting became accepted as an important area to be investigated, researchers attempted to identify key environmental factors which influenced and explained accounting diversity and also attempted to classify different national accounting systems and practices.

Classification and environmental studies

Judgmental Studies

There have been predominantly two approaches to international classification of accounting systems, a judgmental deductive approach and a statistical inductive approach. Examples of classification studies using the judgmental deductive approach include studies by Mueller *(1967, 1968)*, Radebaugh *(1975)*, the American Accounting Association (AAA) *(1977)* and Nobes *(1983, 1984)* all proposing classification systems for

the accounting systems of different countries based on different numbers of variables. All of these classification studies provide a useful initial starting point for examining accounting differences. They all recognise the importance of environmental factors on the development of accounting systems and there is broad agreement between the studies as to what the most important determining factors are. However, there are several problems inherent in this approach :

- wide generalisations are made of environmental factors and their link to the development of accounting patterns. Countries are put into very broad groups based on relatively few factors and this has led to the frameworks being oversimplified and hence of limited use in helping to understand the factors causing international differences in accounting. In addition the frameworks have not been extensively tested empirically and therefore only very general relationships between environmental factors and accounting systems have been proposed.

- countries are forced into mutually exclusive groups with no means of indicating which countries might belong to more than one group or are included in a category which, although the best fit within the choices available, may not be really appropriate

- there is no consistency between the various studies in the groupings suggested and the important factors influencing accounting

- the studies have predominantly used cross sectional methodology which can relate only to a particular point in time. No analysis of the dynamic nature of accounting systems and accounting change have been looked at in the analysis

- culture or the social context in which the accounting systems operated were either not dealt with (perhaps subsumed implicitly in the factors specified) or proxied by overly simplistic variables such as language. The interaction of culture and the institutional, political and legal environment has also not been dealt with.

Following on from these judgemental classification studies, studies on the influence of environmental factors on accounting systems were undertaken by authors such as Choi *(1973a, 1973b, 1974)*, Belkaoui *(1983)*, Puxty et al *(1987)*, Cooke and Wallace *(1990)* and Salter and Doupnik *(1992)*.

Choi *(1973a, 1973b, 1974)* investigated the influence of external variables on the level of corporate reporting in specific countries, proposing and testing the competitive

disclosure hypothesis which suggests that firms competing for access to unregulated markets will increase their disclosures to improve their competitive position.
Belkaoui *(1983)* investigated the links between economic, political and civil indicators and financial reporting and disclosure adequacy. He carried out a linear regression analysis with financial reporting and disclosure activity as the dependent variables and seven factors including the political system, the economic system and Government expenditure per GNP as the independent variables. He concluded that whilst the results of his regression analysis were not significant, the paper indicated the need for research in this area.

Puxty et al *(1987)* presented a framework within which the regulation of accounting practices in four advanced western capitalist countries could be investigated from a critical perspective. They viewed the institutional forms and social processes of regulation as being connected to the ideological forces that are present within nations for example market forces, bureaucratic controls and communitarian ideals i.e. that the mode of regulation within accounting is dependent on the social environment of the country.

Cooke and Wallace *(1990)* empirically tested the effect of the environment on the extent of disclosures in different countries using disclosure indexes. They found that internal environmental factors such as the stage of economic development, goals of society, legal rules, cultural variables, legal systems and political rules determine the accounting systems of western countries but are less useful in explaining the variation in disclosure in less developed countries. They argued that the disclosures in less developed countries were more likely to respond to the needs of foreign enterprises and external influences such as colonial history, international trade, international accounting standards and movement of international accounting firms.

Salter and Doupnik *(1992)* empirically examined the relationship between world-wide legal systems and accounting practices. Using a hierarchical classification of legal systems proposed by David and Brierly and comparing this to accounting based clusters of countries obtained using hierarchical cluster analysis, Salter and Doupnik concluded

that a country's legal system was a significant predictor of which accounting cluster a country would belong to i.e. the legal system of a country could predict the type of accounting system that operates in the country. However, the legal system of a country enabled prediction of the type of accounting system only 62% of the time and hence other factors also need to be considered when trying to explain or predict differences between accounting systems.

Statistical studies

Another approach taken towards the classification of accounting system was the statistical approach, which was based on a search for statistically significant correlations of accounting practices using the Price Waterhouse surveys of international accounting practices of 1973, 1975 and 1979. In one of the most important contributions to this type of research, Frank *(1979)* used factor analysis on the 1973 Price Waterhouse data and emerged with four factors which accounted for a high proportion of the variance of the data. Countries were then allocated to a grouping which reflected the factor with which they had the highest score. The four groupings obtained were

- British Commonwealth model
- Latin American model
- Continental European model
- United States model

In a later article Nair and Frank *(1980)* extended this analysis by separating out measurement practices from disclosure practices and used factor analysis techniques on both the 1973 and the 1975 Price Waterhouse data. Different groupings were obtained for measurement and disclosure tests. The measurement groupings were broadly in line with the spheres of influence patterns of accounting development but the disclosure groupings could not be linked to any of the other classification studies.

As well as the criticisms of judgmental classifications which also apply to this research, there are other criticisms of this approach. The research has established a statistical association between environmental variables and accounting measurement principles

and disclosure practices but has not been able to identify the factors adequately and has not been able to explain the nature of the association between environmental factors and accounting systems. This is perhaps due to the cross sectional nature of the studies and their use of discrete and separately classifiable environmental factors. In addition, the data used in the research was criticised by, amongst others , Nobes *(1984)* as follows:

- specific inaccuracies were present in the data
- there was a general bias in the data since they were based on Price Waterhouse partners perceptions of other countries accounting systems which may not have been accurate especially since they had had a predominantly anglo saxon training
- the partners did not necessarily see a representative sample of clients.

The previous research on factors influencing accounting systems hence has a number of problems, in particular the inappropriateness of the cross sectional methodology at one point in time and the lack of incorporation of the cultural or social environment in the analysis.

Culture and accounting

There have been many studies that suggest that a country's culture is an important factor that affects the accounting system that is seen and is a factor that needs investigation. The focus on the role of culture on accounting was first considered in the international business literature and has become an important area of research mainly since the 1980's within international accounting. For example Jaggi *(1975)*, Choi et al *(1984)*, Bloom and Naciri *(1989)*, Belkaoui *(1989, 1994)*, Violet *(1983)* and McKinnon *(1986)* have all worked on culture and accounting.

Jaggi *(1975)* hypothesised that culture affect a managers disclosure decisions especially regarding the adequacy and accuracy of the information disclosed. He compared the culture of developed countries and less developed countries and concluded that due to

the differences in the cultures between the two, the accounting disclosure systems may not be transferable from the former to the latter.

Choi et al *(1983)* restated some Japanese and Korean financial statements using US GAAP and found that ratios of the Japanese and Korean companies were still very different to those of companies from USA. This demonstrates that accounting is not just a technical tool but that institutional, cultural and political factors are important in understanding differences in accounting systems and financial statements of different countries.

Bloom and Naciri *(1989)* defined culture as

> " the total pattern of human behaviour and its products embodied in thought, speech, action and artefacts and dependent upon man's capacity for learning and transmitting knowledge to succeeding generations through the use of tools, language and systems of abstract thought "
>
> *(Bloom, R., and Naciri, M.A., 1989, page 72)*

from the Websters Third New International Dictionary, Unabridged *(1961)*. They provided an analysis of the similarities and differences in the standard setting process in selected countries, rationalising these differences in terms of the culture of the countries and concluded that standard setting in any country was a function of the economic, political and social environment (culture) of that country.

Belkaoui *(1989, 1994)* also attempted to explicate the links between culture and accounting, proposing a theory on cultural relativism in accounting. The definition of culture used by Belkaoui is one by Kroeber and Kluckholn *(1952)*, from the anthropological literature as follows:

> " Culture consists of patterns, explicit and implicit, of and for behaviour acquired and transmitted by symbols, constituting the distinctive achievements of human groups, including their embodiments in artefacts; the essential core of culture consists of traditional (ie historically derived and selected) ideas and especially their attached values; Cultural systems may on one hand be considered as products of action, on the other as conditioning elements of further action."

(Belkaoui, A.R., 1994, page 51; Kroeber A.L. and Kluckhohn, C., 1951, page 181)

Belkaoui postulated that culture dictates organisational structures, micro-organisational behaviour, the accounting environment and the cognitive functioning of individuals faced by an accounting phenomenon. According to Belkaoui, culture plays an important role in the organisation of everyday understanding in accounting and implies that accounting knowledge is organised in a culturally standardised format which tells individuals how to react to a particular accounting phenomenon.

Violet *(1983)* reviewed the development of international accounting standards with an anthropological perspective and concluded that the success of the IASC had been limited due to cultural variables. He took a socio-cultural approach to his analysis in which there was an attempt to explain social phenomena, which were interactions between individuals and institutions created by their society. These social phenomena were argued to be products of a given culture where the definition of culture used was that of Hoebels as follows :

> an "...integrated system of learned behaviour patterns that are characteristic of the members of a society and that are not the result of biological inheritance. ... Culture is therefore acquired behaviour. But it is as much a part of the natural universe as the stars in the heavens, for it is a natural product of man's activities, and man is part of nature."
>
> *(Violet, W. J., 1983, page 3)*

Violet briefly reviewed the work on culture within the anthropological literature, where it has been recognised that there are a great variety of cultures and cultures grow and develop in response to environmental stimuli and the needs and wants of mankind that need to be satisfied within limited resources. Culture is recognised as the system which encompasses and determines the evolution of social institutions, social phenomena and mankind itself and is viewed as enabling mankind to interpret his environment and explain the immediate, surrounding social phenomena which he faces. Postulates or values of a culture determine a systematic choice by a society for explaining and rationalising social phenomena and based on these postulates, customs are created and adopted. These customs themselves develop into or exist as social institutions.

Accounting is argued to be one such social institution and as such must reflect the postulates of its culture. Violet concluded that each unique culture produces a unique accounting structure shaped by a multitude of cultural constraints and variables and hence culture is an important influencing factor on accounting and needs further investigation.

McKinnon *(1986)* in her work on the historical development of the accounting system in Japan using a social systems approach, too recognised the importance of culture. She argued that the development of accounting, like any social process, is affected by national culture and the institutional environment since "culture influences:

a the norms and values of such systems

b the behaviour of groups in their interactions within and across systems"

(Harrison G., and McKinnon, J.L., 1986, page 239)

McKinnon proposed a modified exogenous framework for studying changes to social systems which incorporates both exogenous and endogenous processes and factors that resulted in changes to social systems. In this framework, accounting was seen as a social system, defined as a system formulated and implemented by social entities with the objectives of fulfilling social functions. Using the framework, McKinnon analysed five accounting changes in Japan from 1890 to 1986 and provided cultural explanations for these changes. McKinnon's framework is detailed later in the chapter.

The Hofstede-Gray framework

Hofstede was one of the first authors to recognise the importance of culture on management and work related practices. Taking an ideational approach in which definitions of culture refer to common frameworks of meanings, social understandings, values, beliefs and symbols, Hofstede *(1980)* defined culture as

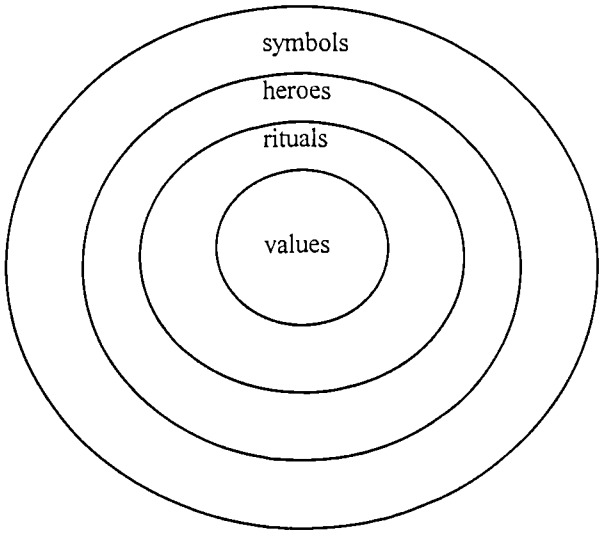
> "the collective programming of the mind which distinguishes the members of one group from another."

(Hofstede G., 1980, page 25)

He viewed culture as the amalgamation of patterns of thinking, feeling and potential acting (also called the "software of the mind") which are learned by individuals usually as a child and which become, subconsciously, part of the individual and "govern" the way individuals are likely to react in certain situations. They do not, of course, predict exactly what an individual will do in any given situation since other factors such as the individual's personality may cause the individual to deviate from expected cultural behaviour.

Hofstede described differences in culture between different groups using the concepts of symbols, heroes, rituals and values as summarised in diagram 1 below:

Diagram 1 *(Hofstede, 1994, figure 1.2, page 9)*



The most superficial level of culture is seen in symbols which are words, gestures, pictures or objects that carry a particular meaning which are only recognised by those who share the culture. Examples of symbols are jargon words used and understood only by individuals from the same culture. The next level at which culture is seen is in the heroes that individuals in the culture choose. Heroes are persons, alive or dead, real or imaginary who possess characteristics which are highly prized in a culture and who thus

serve as role models for behaviour. The third layer of culture is seen in the rituals that are performed and understood by individuals in that culture. Rituals are collective activities, with no technical necessity but which are, within a culture, considered socially essential. For example religious activities and ways of greeting people are all rituals. Even some accounting procedures have been argued by various authors to be purely ritualistic. For example, Feldman and March *(1981)* and Meyer and Rowan *(1983)* have argued that some management accounting procedures are ritualistic rather than technically necessary.

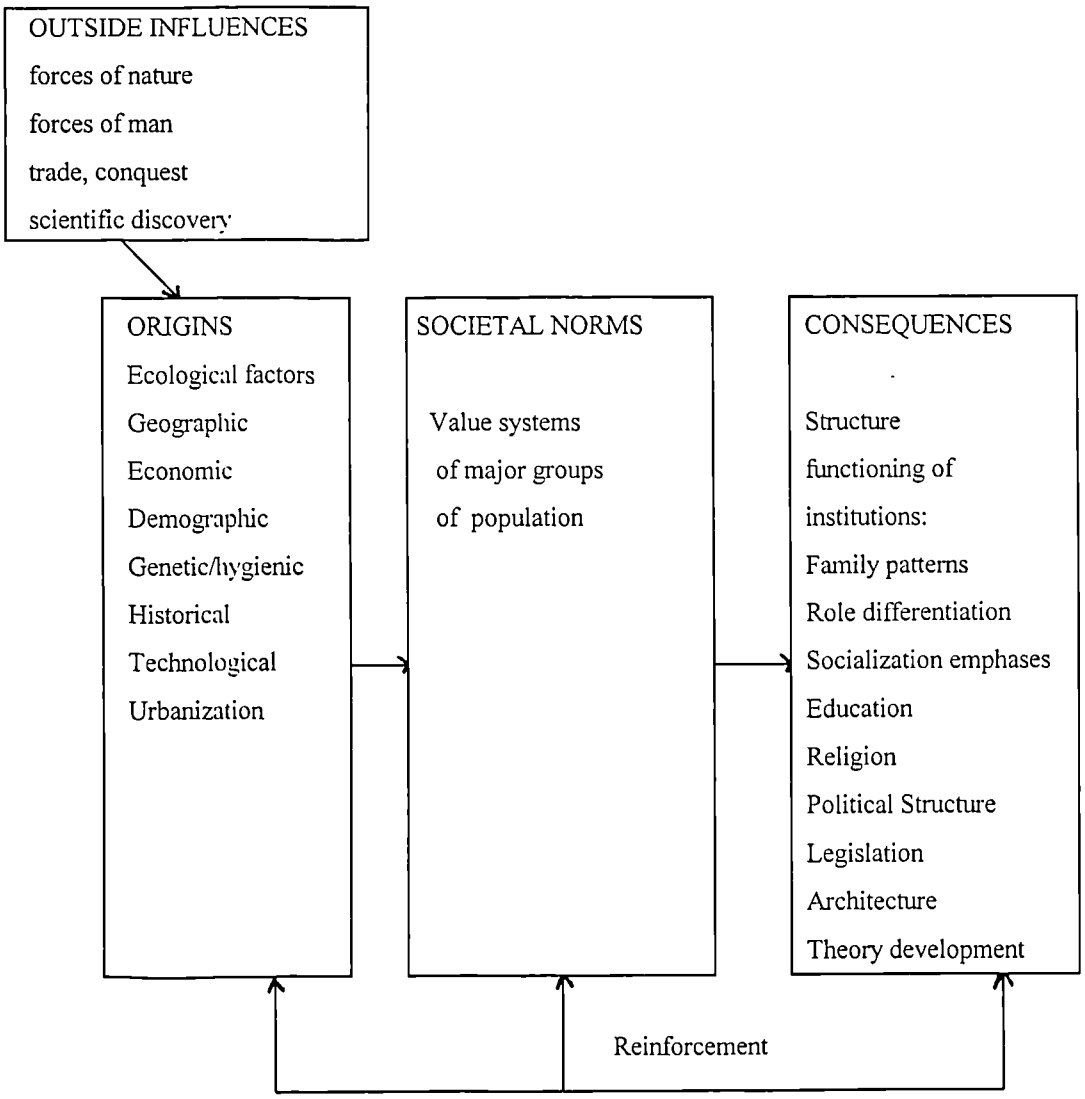
The deepest level of culture is seen in the values that individuals in that culture share. Values are broad tendencies to prefer certain states of affairs over others and are the first things children learn implicitly, usually by the age of ten. Because these values are learnt at such an early age they are usually subconsciously held and are not able to be observed by outsiders. For example people's concepts of right versus wrong and good versus evil are all cultural values. Hofstede argues that it is these cultural values which affect social systems and institutions in any particular country.

Hofstede proposed a model, shown in diagram 2, to explain the mechanisms, origins and consequences of cultural values or societal norms. In the model societal norms and value systems of major groups of population have their origin in ecological factors such as the geography, economy and history of the population. Once developed the societal norms themselves lead to the development of institutions within the society such as family patterns, education, religion and political structure. These institutions then reinforce the societal norms and ecological forces that create them. Change is posited as coming from the outside either through forces of nature or forces of man, for example through trade, conquest or scientific discovery.

Using a survey on matched IBM employees from over 50 countries, and statistical analyses of the answers to the surveys, Hofstede identified four universal dimensions of national culture that differ among countries. Dimensions are defined as aspects of culture

that can be measured relative to other cultures and the four identified by Hofstede in his original study were:

Diagram 2 *(Hofstede, 1980, figure 1.4, page 22)*



- ***individualism versus collectivism*** which relates to the relationship between the individual and the group. Individualism is where individuals are supposed to take care of themselves and their immediate family only whereas collectivism is where there is an expectation for individuals to look after their relatives in exchange for loyalty.

- ***power distance*** which relates to social inequality including relationships with authority. Large power distance is when people accept rigid hierarchical orders and accept that power in society is not distributed equally; small power distance is where people strive for power equalisation and do not accept hierarchies without justification.

- ***femininity versus masculinity*** which relates to concepts of masculinity and femininity i.e. the social implications of having been born as a boy or a girl. Masculinity stands for qualities such as assertiveness and material success whereas femininity stands for qualities such as caring relationships and quality of life.

- ***uncertainty avoidance*** which relates to ways of dealing with uncertainty, the control of aggression and the expression of emotion. Strong uncertainty avoidance arises when there are strong codes of belief with intolerance for anyone who deviates from the accepted viewpoint. Weak uncertainty avoidance arises when there is a more relaxed atmosphere and different viewpoints are more easily tolerated.

In a later study with Michael Bond *(Hofstede 1994; Hofstede and Bond 1988)*, Hofstede found that the dimension of uncertainty avoidance was not appropriate to eastern cultures and identified a dimension unique to the East called Confucian dynamism or long term orientation versus short term orientation. Long term orientation includes a sense of thrift and persistence whereas a short term orientation includes respect for tradition and reciprocation of greetings, favours and gifts.

These dimensions are broadly in agreement with prior research into culture in other disciplines. For example, Inkeles and Levinson, a sociologist and a psychologist, identified the issues of relation to authority, the conception of the self (in particular the relationship between individual and society and the individual's concept of masculinity and femininity) and ways of dealing with conflicts, including the control of aggression and the expression of feelings, as common basic problems world-wide with consequences for the functioning of societies. *(Inkeles and Levinson, 1969).*

There have been some criticisms of Hofstede's work. These include

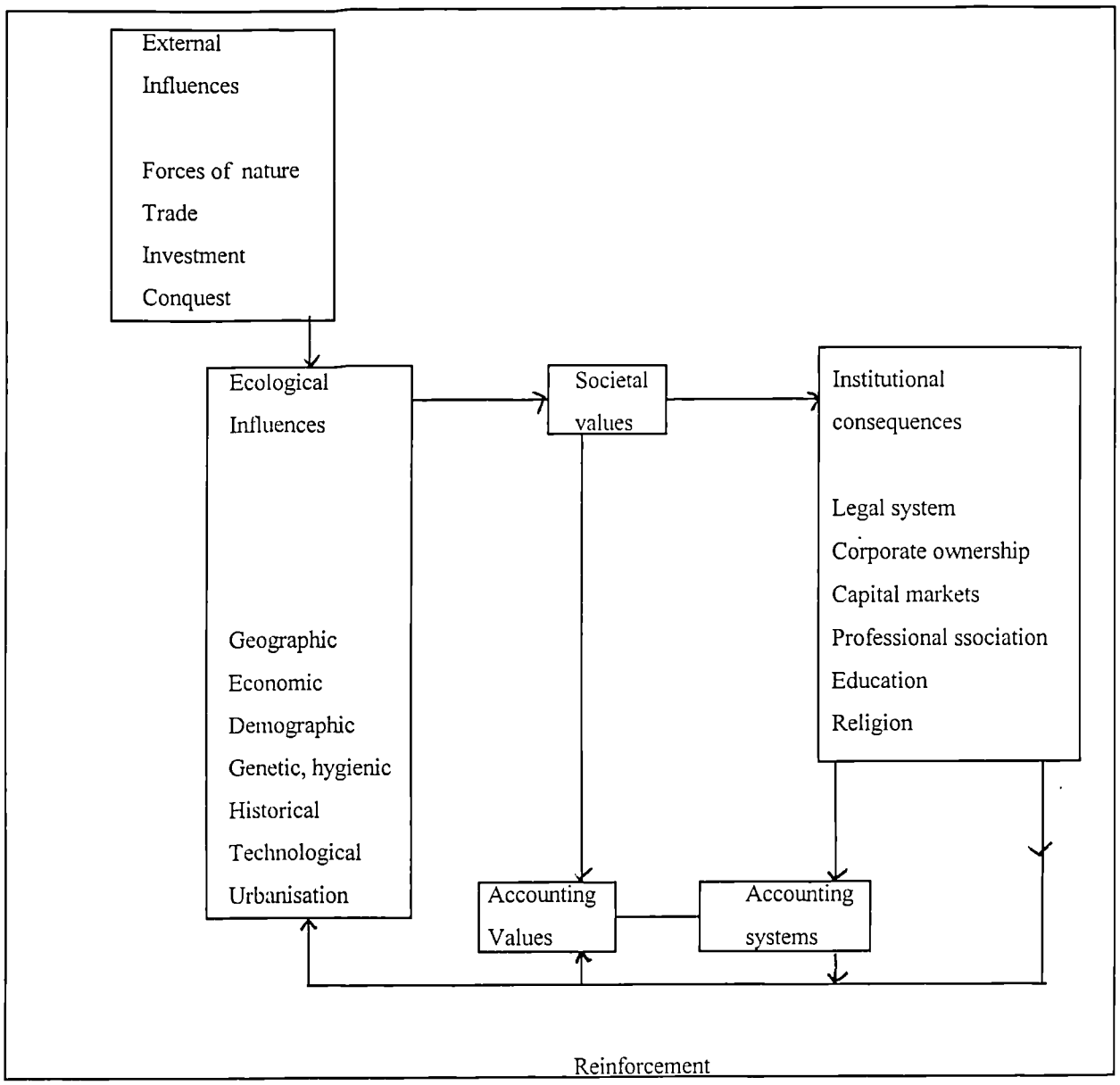
- questions over the survey instrument used by Hofstede not being specifically designed to investigate national cultures and hence not correctly or completely identifying all the universal cultural value dimensions
- some debate over the exact meaning of the dimensions identified
- that focusing on universal cultural dimensions, values specific to nations which may affect management practices and accounting have not been addressed.

However, Hofstede's definition of culture and the dimensions that he proposed are in broad agreement with definitions and dimensions identified in other social science literatures and other researchers subsequent to Hofstede too have identified similar cultural dimensions to Hofstede. This general agreement supports the findings of Hofstede and the framework does, on the whole, provide both a valuable tool for understanding culture, and a way of analysing the impact of culture on management practices.

Gray *(1988)*, following Hofstede, defined culture as the value system shared by major groups of populations. He suggested a theoretical framework linking accounting and culture within which the impact of culture on accounting values and accounting change could be assessed. This model is shown in diagram 3 below.

In the model it is suggested that the origins of culture can be found in factors that affect the physical and ecological environment (for example geographic, economic and historical factors) and that national cultures develop over a period of time and permeate to organisational subcultures. This leads to the development of institutions (for example the legal system, financial markets and professional associations) which, once developed, reinforce the societal or cultural values. In this way cultural values affect the accounting subculture and the accounting values that are seen. Accounting values in turn affect accounting systems which are also affected by institutional consequences, themselves affected by societal or cultural values. Change is posited as coming from external factors such as forces of nature, trade, investment and conquest.

Diagram 3 *(Gray, 1988, diagram 2, page 7)*



Gray identified four accounting values as follows:

- ***professionalism versus statutory control*** - a preference for the exercise of individual professional judgement and the maintenance of professional self regulation, as opposed to compliance with prescriptive legal requirements and statutory control.

- *uniformity versus flexibility* - a preference for the enforcement of uniform accounting practices among companies and for the consistent use of such practices over time, as opposed to flexibility in accordance with the perceived circumstances of individual companies.

- *conservatism versus optimism* - a preference for a cautious approach to measurement so as to cope with the uncertainty of future events, as opposed to a more optimistic, laissez faire, risk-taking approach.

- *secrecy versus transparency* - a preference for confidentiality and the restriction of disclosure of information about the business only to those who are closely involved with its management and financing, as opposed to a more transparent, open and publicly accountable approach.

(Gray, S.J., 1988, page 8)

Gray also proposed hypotheses that linked the accounting values of professionalism versus statutory control, uniformity versus flexibility, conservatism versus optimism and secrecy versus transparency to the four cultural values of power distance, uncertainty avoidance, individualism and masculinity identified by Hofstede. These hypotheses are summarised as follows:

- countries which rank highly in individualism but lower in uncertainty avoidance and power distance are more likely to rank highly in terms of professionalism

- countries which rank highly in uncertainty avoidance and power distance but lower in individualism are more likely to rank highly in terms of uniformity

- countries which rank highly in uncertainty avoidance but lower in individualism and masculinity are more likely to rank highly in terms of conservatism

- countries which rank highly in terms of uncertainty avoidance and power distance and lower in individualism and masculinity are more likely to rank highly in terms of secrecy

(Gray, S.J., 1988, pages 9-11).

These hypotheses were an attempt to link cultural values to accounting values which themselves were linked to four aspects of accounting practice which it was suggested that they were likely to influence:

- authority for accounting systems

- their force of application,
- measurement practices used, and
- the extent of information disclosed

In particular, Gray suggested that

- professionalism would influence the nature of authority for the accounting system
- the degree of uniformity preferred would influence the way in which the accounting system was applied
- the amount of conservatism preferred would influence the measurement practices within the system
- the degree of secrecy preferred would influence the extent of disclosure in the accounting system

He also argued that uncertainty avoidance and individualism were the cultural variables which were likely to have the most impact on accounting values and practices.

Gray's model was a first step in trying to understand the impact of culture on accounting, helping to operationalise the links between culture, accounting values and accounting practices and providing a framework within which the links could be analysed and tested. The advantages of the ideational approach used was that it enabled the identification of key aspects of culture that needed to be analysed in any particular study and provided a framework within which empirical results could be analysed. Indeed, Gray, when he proposed the theoretical framework requested that others further operationalise the link between the accounting variables and the accounting practices he had identified and empirically test the framework.

Gray's framework has been one of the most popular approaches to the analysis of the effect of culture on accounting. For example Perera *(1989)*, Perera and Matthews *(1990)*, Fechner and Kilgore *(1993)*, Baydoun and Willet, *(1995)* and Chow, Chau and Gray *(1995)* have all used the Gray model in their research. However, none of the above articles have tried to test the model empirically in detail.

Empirical testing of the Hofstede-Gray model

The empirical testing of the Gray model has been started by Doupnik and Salter *(1995)*, Salter and Niswander *(1995)* , Gray and Vint *(1995)* and Zarsekei *(1996)*.

Doupnik and Salter *(1995)* synthesised previous models of accounting development proposed by Schweikart *(1985)*, McKinnon *(1986)*, Gray *(1988)* and Robson *(1991)* into one model in which accounting development in any country was viewed as a complex interaction between the external environment, institutional structure and culture. They then tested whether relationships existed between accounting practice and the above elements for a sample of countries, using hierarchical cluster analysis and canonical correlation analysis. The results of this first step in empirically testing a model of accounting development which incorporated the external environment, institutional structure and culture suggested that all three elements were important in contributing to accounting diversity. They also concluded that on a global level, the institutional structure appeared to be the most important of the elements identified.

Salter and Niswander *(1995)* attempted to test the Gray model directly using data from 29 countries and found that Gray's model had statistically significant explanatory power. Using Gray's accounting values as the dependent variables and Hofstede's cultural values as independent variables, Salter and Niswander created their own accounting constructs to operationalise Gray's accounting values and then tested the link between Hofstede's cultural values and Grays accounting values using linear regression techniques on 29 countries. They found that the model was best at explaining actual financial reporting practices but was relatively weak at explaining extant professional and regulatory structures from a cultural base. They also found that incorporating the level of development of financial markets and levels of taxation enhanced the explanatory power of Gray's model. In their conclusion they called for further tests and extensions of the model and suggested that longitudinal studies of accounting change in

different countries were needed to see which of the factors that had been identified were the most important in accounting change in different environments.

Gray and Vint *(1995)* also provided some evidence on the impact of culture on accounting disclosure by applying linear regression techniques to a database of 27 countries. They examined the disclosure element of Gray's model - focusing on the secrecy / transparency dimension identified by Gray. To operationalise the link between secrecy and accounting disclosure practice, Gray and Vint used the number of items of financial and non financial corporate information, both mandatory and voluntary, publicly disclosed by companies - the higher the number of disclosures the lower the secrecy in the accounting subculture of the country., Gray and Vint reclassified the results of the Gray, Campbell, Shaw *(1982/83)* database of disclosure practices into percentage bands ranging from no companies disclosing to most or all of the companies disclosing the information. They then calculated mean disclosure indices which summarised the extent of disclosure in the country across all companies included in the survey.

The impact of culture on accounting disclosure was then assessed by means of linear regression analysis using the mean disclosure scores as the dependent variables and Hofstede's cultural / societal indices as the independent variables. The paper showed support for the hypothesis that secrecy and its impact on disclosure behaviour was a function of the cultural values identified by Hofstede, and that the relationship was more significant in respect of the values of uncertainty avoidance and individualism than power distance and masculinity.

Zarsekei *(1996)* investigated the questions of whether accounting is so culturally driven that harmonisation is completely unattainable and whether there were any factors which could cause culture to change. Using the Gray model, she found that the secretiveness of a culture does underlie disclosure practices, thus providing evidence that supports the Gray model. She concluded that local culture affected disclosure practices of local firms but that global firms operating in an international market place made more disclosures than expected according to their local culture , perhaps to attract international finance at a reasonable cost.

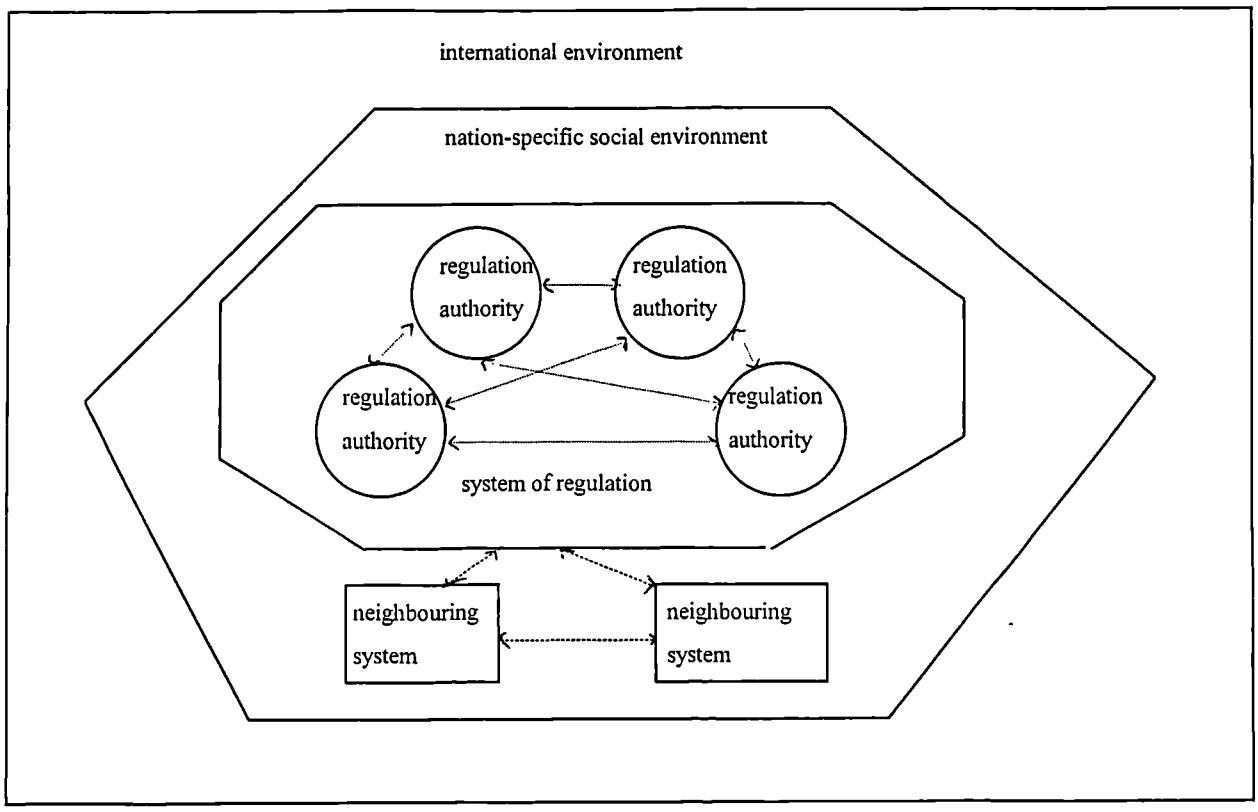
The above research shows support for the framework proposed by Gray but more testing is required, both more empirical tests of large numbers of countries and in-depth single country studies incorporating historical analyses of accounting change and the impact of culture on accounting change and development. In order to undertake in-depth historical studies of single countries, a suitable methodology is needed. Studies are needed that look, not only at the formal operation of accounting systems and their technical outputs, but also at the actual practice of such systems, the institutions that are involved in the systems, and the socio-economic and political environments in which they operate. Investigation of how and why accounting systems develop as they do, and the influence of culture of the process of accounting development and change is also needed. This is particularly important as accounting is no longer seen as a technical process but instead is generally accepted to be a social phenomenon which is both affected by and affects its political, economic and cultural environment.

The work of McKinnon *(1986)* on accounting change within a historical study of accounting development in Japan, provides a possible approach to further the investigation of culture, accounting change and the development of accounting systems. McKinnon's framework is outlined below.

McKinnon's model for analysing accounting change

McKinnon *(1986)* proposes a theoretical model, based on social systems theory and the work of Smith *(1973, 1976)*, for studying accounting change and development within a historical context. The framework is shown in diagram 4 below:

Diagram 4 (McKinnon, 1986, figure 3.3, page 53)



trans-system activity among systems located within authorities the environment and the system of regulation

intra system activity among different within the system of regulation

In this framework, called a modified exogenous framework, financial accounting and corporate reporting regulation are viewed as comprising a social system which is defined as a system formulated and implemented by social entities with the objectives of fulfilling social functions. The accounting system is seen as consisting of the authorities that regulate the system and the ways in which the authorities formulate and administer regulations, the nature of the interactions among the authorities of regulation, and the social status and functions attributed to the different authorities and mechanisms and not just the technical outputs of the system. In addition, the accounting system is not seen as an isolated system but part of the whole institutional environment of the country under study and hence surrounded by other social systems such as the legal system and the financial system which also interact with and affect the accounting system. Finally, the

culture of the country is seen as affecting all the social systems in the country including accounting and not as a variable that affects accounting in isolation. Thus it is not just the technical regulations, but the whole system of corporate reporting (including the institutional environment and the main neighbouring systems within the culture and social context of the country) which is studied.

The model combines elements from both pure endogenous and pure exogenous theories within the sociology literature to try and overcome the limitations inherent in each approach. Endogenous frameworks view social change as a slow and continuous process with change leading to improvements to systems through successive phases. These models are based on evolutionary models used in disciplines such as biology. Social system change is believed to lie within the system itself and thus there is a limited role for external factors of change and for the environment in which the system operates. Exogenous models, on the other hand, view social change as being the result of factors from outside the system being studied, and thus are concerned with the influence of neighbouring systems on the system of interest. However, these models do not incorporate analysis of the system's response to external forces. Thus a modified exogenous framework is proposed within which both external stimuli for change and the system's internal response to the change forces can be studied.

The model is used to study accounting change where this is defined as 'a succession of events which produce over time a transformation of the system under study where a transformation is defined as the replacement or modification of a pre-existing pattern in the system'. McKinnon identifies five key accounting changes (termed key change events) and analyses them into three phases :

- **the source phase,** encompassing events which activate the system towards change. These are usually exogenous to the system.
- **the diffusion phase,** encompassing events which accommodate the change activation forces and disperses them within the system. These are usually endogenous to the system.

- **the reaction phase,** encompassing events which are generated subsequent to and resulting from the diffusion phase events and which serve to moderate or intensify the effect of change. These too are usually endogenous to the system.

Explanations for the change events are then provided in terms of four major aspects:

- **intrusive events** - change stimuli events which usually emanate from without the system and disrupt the systems pre existing pattern.

- **intra-system activity** - the interactions of all institutions and interested parties within the social system under study. This type of activity generates events representing the systems response to change stimuli.

- **trans-system activity** - provides the associational link between the cultural environment and the system under study and refers to the continuous interactions among neighbouring systems and the system under study.

- **the environment** - the set of cultural and social conditions which surround both the system under consideration and the neighbouring systems. Culture is not seen as a single environmental factor affecting only the accounting system but as part of the general environment which is complex and within which all social systems operate.

Using this modified exogenous framework, McKinnon investigates five key changes and provides cultural explanations for the changes that are seen for the development of the accounting framework in Japan. The importance of taking a historical perspective and looking at the actual operation of the accounting system and not just the technical outputs of the system is shown. The framework used by McKinnon is one that may be used in historical studies of accounting change and development in other countries apart from Japan.

From the above, it can be seen that a country's culture has been identified as being an important factor affecting the country's accounting system. The Hofstede-Gray framework has been one of the most popular approaches to investigating the impact of culture on accounting systems and McKinnon has proposed a framework within which the influence of culture on accounting within historical studies of accounting change may be studied. In this thesis, McKinnon's framework on accounting change is combined with Gray's framework on accounting and culture to provide a framework

within which the impact of culture on accounting change and development could be further investigated. This proposed framework is detailed in chapter 3.

In addition to culture influencing accounting systems, politics and political processes too influence accounting systems and accounting change, as discussed below.

Politics and accounting change

Accounting is no longer viewed as purely an objective technique that neutrally portrays the performance of economic entities. Instead, accounting and accounting change are subject to political pressures and processes. Accounting is seen to be influenced by politics in three senses:

- the involvement of government (either implicitly or explicitly) in accounting regulation and accounting change
- the involvement of parliament in accounting regulation and accounting change
- accounting regulation and accounting change being the outcome of the interactions of all parties interested in and affected by accounting.

These political pressures arise for two reasons:

i because the outcome of accounting practices often having significant economic consequences for the preparers and users of accounting reports.

This has been shown, for example by Zeff *(1972, 1978)* who investigated the standard setting process in several countries including the USA and suggested that the process of developing accounting regulations was a political process within which those with economic and other interests tried to influence the accounting regulations promulgated.

ii because accounting is seen as a useful tool for economic and social management as shown by Burchell, Clubb and Hopwood *(1985)*.

The politics of accounting has been investigated by several authors looking at lobbying practices agenda setting, access to key members of committees and other techniques to try and influence accounting and accounting standard setters. In particular, lobbying practices

and written submissions to accounting standard setters on various issues have been studied. This has usually been done without the use of an explicit theoretical model but there has been some research, for example, by Hope and Gray *(1982)* and Sutton *(1984)* who have used theoretical frameworks from political science and economics to study lobbying.

Hope and Gray investigated the political nature of the development of the accounting standard on research and development in the UK. Drawing on the concept of power and using frameworks from the sociology and political science literatures, they analysed the submissions to the exposure drafts (ED 14 and 17) prior to the promulgation of the accounting standard on research and development to identify the various parties interested in the standard. They then tried to attribute influence on policy determination by analysing changes between the exposure draft and the standard and attributing influence to those parties who lobbied for the changes seen.

Sutton *(1984)* used an economic model based on the work on voting in the political science literature. In the model Sutton hypothesised that lobbying took place until the costs of lobbying outweighed the benefits expected to be obtained from the lobbying. Interested parties who had the most to gain from a standard would try to influence the standard setters the most and these were identified to be:

- large companies rather than small companies
- producers of accounting reports that than consumers of such reports
- undiversified parties rather than diversified entities

Once the politics of accounting was identified and accepted as an important part of accounting regulation, two broad research approaches to the investigation of politics and accounting change have been adopted: positive accounting theory as suggested by Watts and Zimmerman *(1979, 1980, 1986)* and a sociological based approach as suggested by Burchell at al *(1985)*.

Watts and Zimmerman proposed a theory based on the self-interested behavior of individuals involved in the accounting process. Self interested individuals would seek

to influence the development of accounting principles in their favour for economic and other benefits. They
advanced the hypothesis that accounting practices were used to reduce agency costs between the independent arms length relationships (for example between shareholders and managers) that existed in the business environment in the USA. They argued that lobbying by corporations was related to the likely impact on the earnings measurement of the corporations and hypothesised that a firm's lobbying policy was related to:

- the remuneration contracts of mangers of organisations
- the amount of debt covenants in the organisation
- the political visibility of organisations

Positive accounting theorists argued that the more a manager's remuneration was dependent on accounting results, the higher the debt in the company and the more politically visible a company was with higher risk of government intervention, the more that firm would be likely to lobby. Using positive accounting theory, research has been carried out on lobbying practices by parties affected by or interested in standard setting and into stock market effects of accounting policy formation in the USA to test the hypotheses proposed by positive accounting theory. However, it is unclear as to whether their findings, even if accepted as completely appropriate to the USA, are appropriate for other countries with different traditions and ways of doing business. Other criticisms of the positive accounting research also include the following:

- the research purports to be the only scientific approach to accounting but the assumptions in the approach are not made explicit, for example the model implicitly assumes that the efficient markets hypothesis holds. The research, like all research, has its own value judgements but these are not explicated
- the approach does not readily incorporate the impact of the environment or culture in the analysis since these are not explicitly included in the model
- the historical antecedents are not explicitly included in the model

Although highlighting the need for investigation of political processes within accounting, the criticisms of positive accounting theory have identified the need for contextual studies of accounting in different countries which look at the politics of accounting within the social, cultural and institutional environment of the country of study.

The other approach to the study of politics and accounting takes a more sociological viewpoint, in which accounting and accounting change is studied in its social context. Developing this perspective Burchell, Clubb and Hopwood *(1985)* analysed the nature of the accounting process from the point of view of understanding social interactions. Arguing that there have been very few attempts to develop general descriptions of the processes involved in the interaction of accounting and its social context, Burchell, Clubb and Hopwood tried to show the process of the interaction of accounting and its social context within a study of the value added statement.

In their study of the value added statement they put forward the idea of accounting change being bound up with how accounting interacts with its environment. Accounting is not seen as just a neutral, objective technique but as a social process and influential mechanism for economic and social management and, as such, open to political processes. They also introduced the idea of an accounting constellation - the idea that accounting change takes place when a constellation of influences come together. The accounting constellation was defined as a "network of intersecting practices, processes and institutions" *(Burchell Clubb and Hopwood, 1985, page 400)* which impact the accounting technique, in this case the value added statement.

The conditions for accounting change were seen as complex, and affected by arguments and political processes within the accounting institutional framework but also by wider social and political arenas affected by accounting. The arenas involved in the case of the value added statement were identified as relating to:

- accounting standards for corporate financial reporting purposes
- employee relations both in recognising and presenting the value of employees to organisations and their remuneration

- concerns about the management of the national economy, especially concerns about inflation.

Burchell, Clubb and Hopwood stated that the factors affecting accounting were different in different instances of change and that accounting was dynamic. Recognising this dynamic nature of accounting they suggested that a historical genealogical study was appropriate and important for studying accounting change and the politics surrounding accounting in different social and cultural contexts.

The link between politics and accounting and its social context is also shown by Lehman and Tinker *(1987)*, albeit with a very different methodological stand. Lehman and Tinker investigated the nature of "interest' in accounting, in particular the part accounting plays as a symbolic and cultural force. They analysed patterns of publishing in both professional and academic accounting journals and compared them with patterns of publishing in other media to illustrate the significance of accounting as political activity in displacing social crises and in adjudicating among different interests in society. Lehman and Tinker are part of the normative critical school of accounting who contest the neutral view of financial accounting faithfully representing rational economic activity.

Instead they argue that financial accounting constructs reality *(Hines, 1988)* and that accounting is political in the sense of being based on a particular ideology, the capitalist ideology. Accounting is not only argued to be part of the political struggle in society but also that the outcomes of accounting policy determination is essentially political - i.e. operating to the benefit of some in society and not others. This involves normative value judgements as to who should benefit and who should not. Authors such as Lehman and Tinker view accounting as biased towards capitalism and maintaining the status quo and are critical of this.

From the above, it can be seen that the political processes surrounding accounting are important in determining how accounting is likely to change. Whatever methodological stance has been taken most of the work on the politics of accounting has been carried out on the accounting systems in anglo saxon contexts *(Nobes, 1992;*

Power 1992; Robson 1991; Robson 1993; Young 1994; Puxty et al 1987; Cooper and Shearer 1984; Cooper 1980; Watts and Zimmerman 1990), and, in particular, investigating the politics surrounding accounting standard setting and the standard setters (FASB in the USA, ASC / ASB in the UK).

Although there have been very few detailed studies on the politics of accounting in non anglo saxon countries, the work by Puxty et al *(1987)* and Willmot et al *(1992)* looks at accounting regulation and politics in some European countries as well as the UK and the USA. Their work focuses on the roles of accounting in regulating economic and social activities in society and the manner in which the institutions in involved in accounting are themselves regulated in different countries. Using a framework based on the work of Streeck and Schmitter *(1985),* they identify three organising principles for regulation in any particular country - the market (market forces), the state (bureaucratic controls) and the community (communitarian ideals) with accounting being subject to some government intervention and also subject to some consensus reaching political processes in all countries.

Puxty et al *(1987)* analyse and compare the modes of accounting regulation in the Federal Republic of Germany, the United Kingdom, Sweden and the United States of America. They argue that all the advanced capitalist countries show regulation processes that are a combination of the three different modes of regulation outlined above and that different countries show different combinations of these different regulatory modes. Willmot et al *(1992),* using the same model, compare and analyse the accounting treatment for research and development in the same four advanced capitalist countries, stressing the importance of political analyses of accounting within the institutional and cultural contexts of countries. They conclude that each of the four advanced capitalist countries has a different set of institutional arrangements and processes, which they use to regulate accounting, accounts and accountants. The different arrangements are due to different cultures, histories, socio-political structures and patterns of supra-national influences. They also conclude that the regulatory modes are shifting and coming closer together due to an increase in both regulatory agencies and in financial capital. There have also been a few recent studies on

accounting and politics in European countries *(Illes et al 1996; Mcleay, Ordleheide and Young, 2000)* but little work has been done on accounting in developing countries.

From the above, it can be seen that, as well as being affected by culture, accounting is very much affected by politics. Studies which look at the political processes in accounting regulation within the institutional and cultural framework of countries are needed. In particular, studies which analyse political processes in countries with different accounting frameworks, business environments, cultures and traditions to that of anglo saxon or European countries are needed to provide further insights on the process of accounting change and the development of accounting systems.

There have been some historical studies of accounting and accountants in anglo saxon and western countries, for example by Zeff *(1972)*, Parker *(1989)*, Carnegie and Parker *(1996, 1999)* but the historical studies of the development of accounting frameworks that have been carried out have mainly concentrated on developed, Anglo American or European nations and little work has been carried out on developing nations.

Indeed, reviews of international accounting by Previts *(1975)*, Mueller *(1979)*, Schoenfeld *(1981)*, Gray *(1983)*, Samuels and Piper *(1985)*, Bindon and Gernon *(1987)*, Meek and Saudagaran *(1990)*, Cooke and Wallace *(1990)*, Wallace and Gernon *(1991)* and Falk *(1995)*, have all argued that studies which look at the interrelationships between accounting, culture, social concerns, politics and economics are needed which focus on how international patterns of accounting are changing and what the major factors involved are. In particular, historical analyses of accounting change are required for non western, non anglo saxon countries. The research in this thesis provides an analysis of the influence of culture and politics on accounting change in India, an important developing country.

Accounting Research on India

There have been a few studies on the accounting in India since the 1960's which have mainly focused on disclosure studies or cross national comparisons of corporate reporting between India and either the USA or the UK

Singhvi *(1967)* undertook a comparative study of corporate disclosure through annual reports between the USA and India in 1967 for his doctoral dissertation and in 1971 Singhvi and Desai *(1971)* carried out an empirical analysis of the quality of corporate financial disclosure, concluding that the quality of disclosure by Indian Companies was poor.

In 1972, G.P. Kapadia *(1972)* published a book on the history of the accountancy profession in India, detailing the setting up of the Institute of Chartered Accountants of India and the setting up of the Institute of Cost and Works Accountants of India. The book detailed the main processes and interactions between the main parties interested in the accounting profession in India until 1970. However, the book did not look at changes to the accounting system which did not involve the accounting profession.

Enthoven *(1979)* included a brief description of the accounting system in India in his book Accountancy Systems and the Third World and made some suggestions for accounting reform. His summary included a description of the public sector accounting system.

In 1977, Das Gupta *(1977)* undertook a review of accounting in India, which included a brief review of accounting in India since 1882 . However, no detailed analysis of accounting change was undertaken and the study focused on accounting in India in the 1970's.

Marston *(1986)* reviewed the accounting environment in the UK and in India, looking at the extent to which differing influencing environmental factors might give rise to variations in the different accounting practices that are seen. The study included an

empirical analysis of the level of disclosure of information (income measurement, asset valuation and corporate disclosures) by Indian Companies as compared to UK Companies and results were compared to other surveys, for example by Singhvi.

Another disclosure index study was carried out by Chander *(1992)*, who compared disclosure in the private and public sector. The study included a brief review of accounting practices in India but did not detail accounting changes that did not relate to the ICAI or the Companies Act and did not undertake a detailed analysis of accounting change in India since independence.

In 1994, Chakravorty *(1994)* undertook a study of changes to the Companies Acts 1882, 1913, 1936 and 1956 and reviewed some of the development in accounting in India since independence. However Chakravorty, again, only reviewed changes to the Companies Act and changes relating to the ICAI. No detailed analysis of accounting change in India since independence was undertaken.

The research in this thesis, therefore, provides an in-depth analysis of accounting change in India, a key developing country and provides a detailed historical analysis of accounting change.

Conclusion

Culture and politics have been identified as important factors influencing accounting systems and the process of accounting change. Culture is recognised as the system, encompassing the evolution of social institutions and social phenomena, which enables mankind to interpret his environment and the social phenomena that he faces. Culture is learned or acquired behaviour resulting from man's response to his environment which, once acquired, then conditions man's response to his social environment. The values of a culture determine a systematic choice by a society for explaining and rationalising social phenomena and based on these values, customs are created and adopted. These

customs themselves develop into or exist as social institutions. Accounting is argued to be one such social institution and as such must reflect the values of its culture. Politics is also seen to be an important influence on accounting and has been defined as the influence of government on accounting, the influence of parliament on accounting and accounting being the result of interactions between all the parties interested and involved in accounting.

Historical studies of accounting change in developing countries have been identified as an important addition to the literature on culture and politics on accounting systems. A suitable methodology is needed in order to investigate the influence of culture and politics on accounting in single countries and on the process of accounting change. This thesis proposes a model based on the frameworks of Gray *(1988)* and McKinnon *(1986)*, which have been discussed briefly in this chapter. The model proposed in this thesis is discussed in more detail in chapter 3, together with an identification of the changes to be analysed in the thesis and the data sources for the analysis.

Chapter 3

Methodology

Introduction

The exploratory research in this thesis analyses the influence of culture and politics on accounting change and development in India. This is done by identifying major changes to the accounting system in India from independence in 1947 to 1998. The changes are then analysed using a theoretical framework *(Verma S., and Gray S.J., 1998)*, which is based on the work of Gray (1988) and McKinnon (1986), discussed in chapter 2. The research also involves identifying the social, cultural, economic, historical and political context, identifying the development of the accounting framework and identifying the accounting values in India.

The theoretical framework used to analyse accounting change in India and the collection of data for the research is discussed below.

Theoretical framework for analysing accounting change

To enable the investigation of culture and politics on accounting change, this thesis proposes a theoretical framework within which the analysis of accounting change in single countries can be undertaken. The theoretical framework proposed, combines and adapts the theoretical frameworks proposed by Gray (1988) and McKinnon (1986), as discussed in chapter 2. The adapted theoretical framework is shown in diagram 1.

The accounting system is viewed as part of the whole social system in the country of study, including the authorities, which formulate the regulations, the institutional environment within the system, and interactions among all the different parts of the system. The accounting system is neighboured by other social systems, such as the legal, economic and political systems, which both affect and are affected by the

accounting system. All social systems operate within the culture of the country, which affects both the interactions among different parts of the accounting system and the interactions among the accounting system and its neighbouring system.

The Source Phase and Intrusive Events

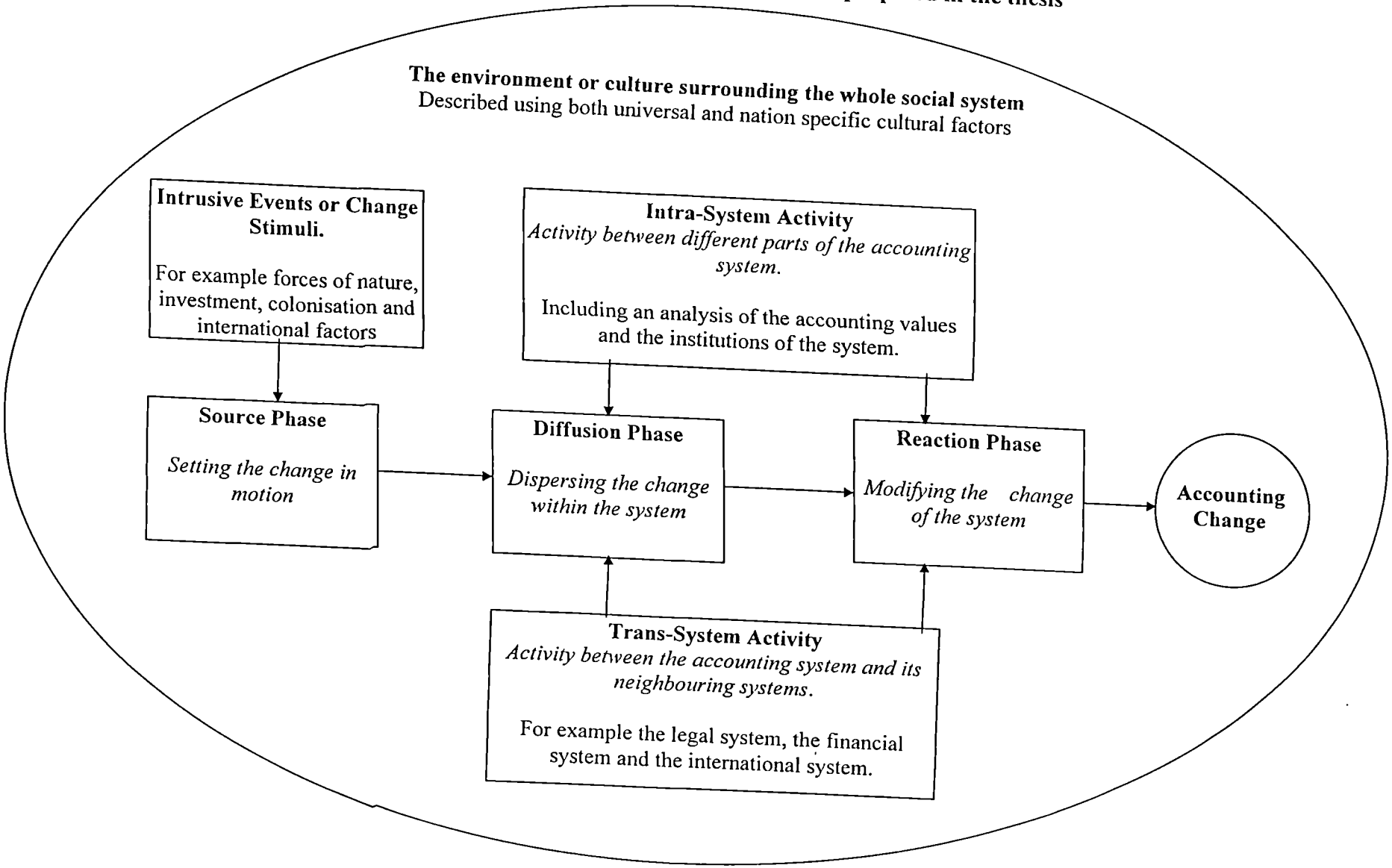
The source phase encompasses the factors or events causing change to occur. These are expected to arise from outside the accounting system and consist mainly of exogenous processes. It is expected that factors such as colonisation, imperialism, war, economic and political interdependence and international influences will play a significant role in stimulating change.

The Diffusion Phase - Intra-System Activity and Trans-System Activity

The diffusion phase of any change looks at how change is dispersed and accommodated within the system. This will encompass both intra-system activity, (activity between the different components of the accounting system) and trans-system activity, (activity between the accounting system and its neighbouring systems).

It is expected that the most important aspects of intra-system activity, which will determine how the accounting system accommodates change, will involve the interaction between accounting values and the institutional framework within the accounting system and interactions between the different regulatory institutions within the accounting system. In India, the main regulatory institutions within the accounting system are identified to be the Department of Company Affairs, the Institute of Chartered Accountants of India, the Institute of Cost and Works Accountants of India and the Institute of Company Secretaries of India.

Diagram 5 – Theoretical Framework proposed in the thesis



Trans system activity will also be involved in determining how change is accommodated within the accounting system. It is expected that, in any country, the social systems that are most likely to affect the accounting system are the legal system, the political system, government activity, the corporate system, the economic system, the financial system and the international system. In India, the main systems that affect and are affected by accounting are the economic system, the parliamentary system, the corporate sector, the tax system and the international system.

Important accounting changes over a period of time are identified and analysed into source, diffusion and reaction phases as follows:

The Reaction Phase - Intra System Activity and Trans System Activity

The reaction phase of any accounting change encompasses how the accounting change will finally be incorporated into the accounting system and looks at how the accounting system is modified subsequent to the diffusion phase of the change. Again, it is expected that both intra-system activity and trans-system activity will be important in this phase. Thus analyses of interactions among accounting values and institutional frameworks within the accounting system, and interactions among the accounting system and key neighbouring social systems as posited above will be required. This phase is expected to consist of mainly endogenous processes.

The Environment and politics in All Phases of Accounting Change

The environment or the culture and social context of the country affects all systems and all phases of change events described above. The key components of culture appropriate to changes in the accounting system will be analysed in terms of both the universal cultural values identified by Hofstede, and other components of culture specific to the country of analysis. It is expected that both nation-specific cultural values and universal dimensions of culture will be important in the analysis of accounting change. Culture and social context are not treated as a single separate factor that affects accounting in isolation; instead it is viewed as affecting all the systems in the country and all the

neighbouring systems to the system under study. Culture and social context are part of the general environment within which all the social systems in the country operate.

In addition, the links between politics and accounting are expected to be important in all phases of any accounting change since the outcome of any accounting change is the result of political negotiation between all parties interested in accounting. Interested parties will therefore try to influence all phases of any accounting change.

Identification of key changes to the accounting system

Key changes to the accounting system in India are analysed using the theoretical framework proposed above and the benefits and problems associated with the framework are assessed to see if the framework does, indeed, help in the analysis of accounting change in a single country.

Three types of changes are identified. These cover the development of the main institutions involved in accounting, the processes used to promulgate accounting regulations and changes to accounting regulations themselves. The study therefore looks at the institutional framework surrounding accounting, the actual operation of the accounting system and the process of change, rather than at just the technical accounting regulations.

The changes to the accounting system in India chosen for analysis are the following:

- the promulgation of the Companies Act 1956 and major changes to the Companies Act since its promulgation in 1956. These changes took place in 1974 and 1988. In addition, an attempt to change the Companies Act 1956 took place in 1997 and this too is analysed.
- the setting up of the Institute of Chartered Accountants of India (ICAI) in 1947 and the setting up of the standard setting process by the ICAI in 1977.
- the setting up of the Institute of Cost and Works Accountants of India (ICWAI) in 1959 and the subsequent requirements for certain companies to keep cost accounting records and requirements for these companies to have a cost audit.
- the requirement for certain companies to have tax audits in 1986 and the promulgation of tax accounting standards by the tax authorities in the 1990's.

These changes are identified to be the most important changes to the accounting system in the period from 1947 to 1999, through a review of the literature and in discussions with the main parties involved in the accounting system in India during visits to India in 1995, 1996 and 1997 to collect data. These discussions were held with the following:

- indian academics.
- senior accounting personnel in companies, both Indian companies and multinational companies.
- senior personnel in the stock exchanges and the Securities and Exchange Board of India (SEBI).
- senior personnel in the accounting profession – both auditors in practice and accountants working in industry.
- the Institute of Chartered Accountants of India, the Institute of Cost and Works Accountants of India and the Institute of Company Secretaries of India.
- government officials from the Department of Company Affairs and the tax authorities.

Confirmation that these were the most important accounting changes in India was obtained in the formal interviews with the main parties interested and involved in accounting change in India, conducted in October and November 1998, in India.

The changes were then analysed using the theoretical framework proposed above and the usefulness of the framework in analysing the changes assessed. In addition to books on accounting in India, data for the analysis was obtained from the following;

- survey of accounts of companies for the financial year ending in 1996.
- survey of accounts of companies from 1947 to 1996.
- analysis of parliamentary debates and reports.
- analysis of the journal of the institute of chartered accountants.
- interviews with the main parties interested, and involved, in accounting.

This data is also used to identify the social cultural, historical and political context of India, the development of the accounting framework and accounting values in India. The collection and use of data is discussed below.

Data Sources

Survey of accounts of companies for financial years ending in 1996.

A survey of accounts of companies for the financial year ending in 1996 is undertaken for the following reasons:

- to help identify the current accounting framework in India. Details on accounting regulations, actual accounting practices and voluntary accounting practices are obtained.
- to help identify accounting changes and to obtain information as to why changes are taking place.
- to help identify and evaluate the accounting values that are part of the accounting system in India. Hofstede *(1980)* identifies India to have the following cultural values:

  - low individualism
  - low uncertainty avoidance
  - high power distance
  - high masculinity

  This leads us to predict that India will have an accounting system with both professionalism and statutory control, uniformity, both optimism and conservatism and both secrecy and transparency. The accounting values are discussed in more detail in chapter 5.

Choice of Companies

In order to study accounting change in India since independence, companies ranked in the top 200 listed companies in India, which have been in existence since the 1940's and 1950's were chosen for analysis. These companies were the largest and most influential listed companies in India and were chosen for analysis since they matched the time period for the study, were subject to all the accounting regulations extant in India and were the companies with the most international relevance.

89 companies met this criteria and were contacted several times to obtain accounts. Accounts for all 89 companies were obtained. Accounts were obtained from 62 companies, by contacting the companies directly for their accounts, a response rate of 70%. The accounts of companies who did not provide their accounts were obtained from the Bombay Stock Exchange in India, from direct visits to companies and from

a contact in a financial institution in India. Of the 89 companies in the sample, approximately 1/3 were multinationals or foreign owned companies and 2/3 were Indian owned companies. The companies surveyed are identified in appendix 1.

Survey questions

The survey looked at two main areas:

- **areas which are regulated by different forms of regulation.**

  What is regulated and how it is regulated is expected to be dependent, at least partly, upon the culture and social context of the country of study. In addition, all types of regulations are subject to political processes, both in terms of government involvement in regulation and interested parties trying to influence the process for promulgating the regulations. The analysis of areas covered by different regulations, therefore, provides insights into the link between politics, culture and accounting and is chosen for investigation in this study.

  In the survey, areas which are regulated by different regulations and which are covered by international accounting standards, indicating international relevance and importance, are included.

  The three main forms of regulation in India are

  - regulation by statutory means, mainly by the Companies Act 1956
  - regulation by the ICAI who issue accounting standards
  - regulation by the Securities and Exchange Board of India (SEBI) and the stock exchanges. In practice, SEBI and the stock exchanges leave most of the regulation of financial reporting and accounting to the Companies Act 1956 and the ICAI. The two exceptions are in respect of debenture redemption reserves and the cashflow statement. *(chapters 4 and 5)*

- **voluntary disclosures**

  Voluntary disclosures are likely to be affected by culture, both in terms of what is disclosed and how these disclosures are made. The study of voluntary disclosures is therefore likely to provide useful insights into the links between culture and accounting. *(chapter 5)*

The survey includes questions on the following areas:

- Formats for balance sheets
- Disclosure of accounting policies and accounting policy changes
- Reserves
- Fixed assets and depreciation
- Investments
- Inventories
- Contingent liabilities
- Revenue recognition
- Exceptional, extraordinary and prior period items
- Taxes
- Pension costs and retirement benefits
- Government grants
- Audit
- Cashflow statements
- Statement of Source and application of funds

-	Strategic Information	- general corporate information - corporate strategy -acquisition,amalgamation,disposals and collaborations - research and development, technology innovation and absorption and conservation of energy
-	Non financial Information	- directors and higher paid employees - other employees -social policy, environment and value added information
-	Financial Information	- segmental information - financial review - foreign currency - stock price information

For each area, questions are spilt between questions on whether statutory regulations are being followed if applicable, whether accounting standards set by the Institute of Chartered Accountants of India are being followed if applicable, whether stock exchange regulations are being followed if applicable and what voluntary disclosures are being made.

The survey included four possible answers to each question

- "yes" if the regulation was followed or the voluntary disclosure was given.
- "no" if the regulation was not followed or the voluntary disclosure was not given.
- "not applicable" if the question was not relevant to the company.
- "don't know" if the area was relevant but the accounts did not give enough information to know whether the regulation was being followed or not.

In the design of the survey, the choice of questions were informed by a review of the literature, a preliminary review of 6 financial statements of companies for the financial year ending in 1995 and informal discussions with the parties involved in the accounting system in India during trips to India to collect data, as identified above.

Once the survey had been designed, it was tested on four companies, two multinational companies and two Indian owned companies. Any ambiguous questions were amended and the survey finalised. The survey questionnaire is given in appendix 2.

The survey was then carried out on all 89 company accounts. As well as answering the questions in the survey, qualitative comments made in the accounts were noted, where these were deemed to be interesting and relevant to the study.

Once the survey was completed, all answers were checked for consistency and to check correctness of answers. The main results from the survey are given in chapter 5 on the accounting framework and used in the analysis of the accounting changes in chapters 6 to 13.

Survey of past accounts from 1940's to 1990's.

A survey of accounts for companies from the 1940's and 1950's to 1996 is undertaken:

- to help identify the accounting framework in India since independence.
- to help identify actual accounting practices in India since independence.

- to help identify the main changes in the accounting framework in India which will be investigated by the study.
- to obtain information on the reasons for the accounting changes seen.
- to obtain the views of the corporate sector on the accounting changes seen.

The same survey that was undertaken on 1996 accounts was used to survey accounts of Indian owned and multinational companies dating back to the 1940's and 1950's.

Choice of Companies

Within the survey of company accounts from the 1940's and 1950's to 1996, two surveys are undertaken, a survey of companies from the 1970's to 1996 and a survey of companies from the 1940's and 1950's to 1996, as follows:

Survey of company accounts from the 1970's to the 1990's.

Of the companies that have been in existence in the 1940's and the 1950's, fifteen companies were chosen to be surveyed. Of these, five were multinationals, nine were Indian owned companies and one company was a multinational which was taken over by the Indian government in 1974. The multinational companies were chosen to represent multinationals from as many different countries as possible. The Indian companies were chosen to represent as many of the large family owned groups of companies in India as possible. All the companies were large, well known, influential companies in India and representative of the companies, both Indian owned and multinational, in existence in India since independence.

The survey that was carried out was the same survey that was carried out on the accounts for the year ended 1996. The survey was carried out on accounts every five years and the accounts chosen were accounts for the periods ending in 1970, 1975, 1980, 1985, 1990, wherever possible. Where these accounts were not available, the nearest years to the ones identified above that could be obtained were surveyed. The companies surveyed are given in appendix 3.

Survey of company accounts from the 1940's and 1950's to the 1990's.

For six of the fifteen companies, accounts from the 1940's and the 1950's to the 1990's were surveyed. The survey was again the same as for the 1996 accounts and was carried out on accounting periods ending 1945, 1950, 1955, 1960, 1965, 1970, 1975, 1980, 1985 and 1990. Again, if these accounts were missing, the nearest accounts available to the chosen years were surveyed. The companies surveyed are given in appendix 3.

It was only possible to analyse the accounts of a relatively few companies from the 1940's and 1950's to the 1990's, due to constraints on the availability of data and the co-operation of companies. Despite this, the information obtained from the survey was interesting and useful within the context of this exploratory research. The survey helped confirm that the accounting changes that were identified in discussions with the different parties involved in the accounting system were the most important changes and that all the important changes had been identified. The results of the survey are given in chapter 5 on the accounting framework and used in the analysis of the accounting changes in chapters 6 to 13, where appropriate.

Review of Parliamentary debates and reports

Statutory legislation promulgated through the parliamentary system is commonly used to promulgate accounting change. Indeed, in all but one of the accounting changes analysed, statutory legislation has been used at some stage of the change. Thus parliamentary debates and parliamentary reports on the legislation have been reviewed, where available, to help in the analysis of the accounting changes. Where committees have been set up to look at accounting change outside the parliamentary process, these reports too are reviewed, where available. The parliamentary reports and debates are used extensively in the analysis of the changes in chapters 6 to 13 and are given in appendix 4. These reports and debates help in:

- identifying reasons for accounting changes.
- identifying interactions between the different parties involved and interested in the accounting system.
- identifying the process of accounting change.

- identifying the influence of politics and political processes on accounting.
- identifying the influence of the social and economic context on accounting.

Analysis of the Journal of Institute of the Chartered Accountants of India (ICAI)

The Institute of Chartered Accountants of India (ICAI) have published a journal, called "The Chartered Accountant" since July 1952. As well as detailing technical accounting regulations, the journal provides information on:

- the main changes to the accounting system.
- how and why changes take place.
- the effect of culture and political processes on accounting change.
- the interactions of the ICAI with others involved in accounting change and the accounting system.

The journal is reviewed for articles that cover the following topics which are relevant to this study:

- the social role of accounting and of accountants.
- the economic role of accounting.
- major accounting changes as identified above.
- interactions of the ICAI and accounting with parties interested in accounting for example the Government, Parliament, the Companies Act 1956 and other statutory legislation, the ICWAI, ICSI, the tax authorities, the stock exchanges and SEBI.
- reviews of the accounting profession in India and the future of the accounting profession in India.

The journal is published monthly and all issues of the journal, apart from 12 issues which were not available, were reviewed from July 1952 to December 1998. Articles from the journal are extensively used in the analysis of the key changes to the accounting system in chapters 6 to 13.

Interviews

Interviews were conducted with as many of the parties involved and interested in the accounting system in India as possible. The interviews were semi-structured

interviews based on an interview questionnaire. Semi-structured interviews were chosen to give some structure to the interviews such that the key issues and changes were addressed but with some flexibility such that interesting discussions in the interviews could also be pursued.

The interview questionnaire was designed in two parts. The first part covered general questions on the accounting framework in India and subject to the availability of time, was included in most interviews. This part of the interview was designed to help identify the key accounting institutions and regulations in India, the main parties involved in accounting in India, the accounting values in India and the interactions between different parties involved in accounting in India.

The second part of the questionnaire covered the specific changes identified above and focused on the reasons for the changes, the process of change and the interactions between the different parties involved in the change. The changes were discussed with the most appropriate interviewees.

Once the questionnaire was designed, it was pretested in an interview with a senior Indian academic in September 1998 in London and modified. It was found that the initial interview questionnaire designed was too long and the questionnaire was restructured in sections such that questions could easily be added or deleted depending on the time available for the interview. The interview questionnaire is given in appendix 5.

Interviews were conducted in India in October and November 1998 with many different parties interested in accounting. These included:

- senior accounting personnel in companies (6 interviewees)
- international auditing firms (1interviewee)
- Indian auditing firms (2 interviewees)
- the professional accounting institutes in India - ICAI, ICWAI, ICSI (4 interviewees)
- senior representative of SEBI (2 interviewees)
- senior representatives of the stock exchanges (2 interviewees)
- representatives of the Department of Company Affairs (2 interviewees)

- representatives of the Central Bureau of direct taxes in the Ministry of Finance, (1 interviewee)
- Indian academics (2 interviewees)

Wherever possible, interviews with more than one representative of each group was conducted, although this was not possible with the tax authorities.

In total, 22 interviews were conducted, with each interview lasting on average between one and two hours. In a few cases, where interviewees were only able to give interviews which lasted less than one hour, only the changes most appropriate were discussed and the general questions shortened or deleted from the interviews.

The interviews were, wherever possible, taped. Where taping was not allowed, notes were made of the interviews. In general, government officials did not allow their interviews to be taped. All other interviewees did not object to having their interviews taped. Details of the interviews conducted are given in appendix 6. The taped interviews were then transcribed and checked. The results of the interviews are used in the analysis of the accounting changes in chapters six to thirteen.

Limitations of the Research

There are limitations to the research undertaken in this thesis, as there are with any research. These limitations include:

- accounting change is complex and the framework used to analyse data can only provide a simplified analysis of reality. This is a problem which is present in any framework or model.
- culture is a complex concept with many different facets. In the research, a decision on the most important facets of culture relevant to the study will have to be made. This is an issue relevant to any research which involves cultural considerations.
- the choice of which changes to analyse is, to some extent, subjective. However, attempts to minimise this subjectivity are made by:
    - identifying the major changes to the accounting system using more than one source of data.

- obtaining confirmation that no major changes to the accounting system have been excluded, in the interviews.

- in the survey of accounts for companies for the financial year 1996, all 89 companies which best matched the time period for the study were surveyed. However, only 89 companies are surveyed and no company which started business after the 1950's is analysed. The 89 companies are expected to be representative of the large, economically significant companies in India and hence an acceptable and representative sample for this exploratory research.

- in the survey of old accounts, relatively few company accounts were analysed (15 companies dating back to the 1970's and 6 dating back to the 1950's). The number of old company accounts was constrained by the availability of the data and co-operation of companies. However, despite this, the old accounts did provide interesting information for the research.

- many parliamentary debates and reports were analysed but some reports were not available and this limited the analysis that could be done. However, for each change where such reports were relevant, the key reports were obtained and reviewed.

- 22 formal interviews were conducted in October and November 1998. In addition, informal discussions were held with the different parties interested in accounting in India, during trips to collect data from 1995 to 1998. Access to most of the different parties was obtained and efforts were made to interview at least 2 people in each category, but this was not always possible. In addition, access to some parties such as the Comptroller and Auditor General of India was not gained. However, the 22 interviews did cover most of the parties interested in accounting and hence most points of view were obtained.

- the *research in this thesis covers changes, some of which dates back to the* 1940's. In many cases, the interviewees had no knowledge of some of the changes chosen for analysis. Where interviewees did have some knowledge of the changes chosen for analysis, the answers were dependent on what the interviewees could remember. In addition, the information obtained in the interviews was subject to what interviewees were prepared to disclose. However, most interviewees, even those who were not prepared to be taped, did not appear to be withholding information.

Conclusion

In this chapter, a framework, adapting the work of Gray and McKinnon is proposed, which is expected to facilitate the analysis of culture and politics on accounting change and development in a single country. In the framework, each change is broken down into source, diffusion and reaction phases. The source phase is

expected to comprise of mainly exogenous activity. The source and the diffusion comprise of intra-system activity and trans-system activity. Culture and social context and political processes are expected to influence all phases of the change.

The framework is used to analyse and investigate the main accounting changes in India which are identified to be:

- the promulgation of the Companies Act 1956 and changes to the Companies Act in 1974, 1988 and 1997.
- the setting up of the ICAI in 1949 and the setting up of the standard setting process by the ICAI in 1977.
- the setting up of the ICWAI in 1959.
- the promulgation of the tax audit requirements in 1986 and tax accounting standard setting by the tax authorities in 1996.

Data for the analysis comes from a variety of sources which include:

- literature on India, including literature on culture, politics and accounting.
- survey of accounts of companies for the year ending in 1996.
- survey of accounts of companies from 1947 to 1996.
- review of parliamentary debates and reports.
- articles from "The Chartered Accountant", the journal of the ICAI.
- interviews with the main parties interested in accounting.

The different types of data help to try and ensure that all the main accounting changes are covered and that there is support for the conclusions reached from more than one source of information. This helps to improve the reliability of the findings of the research. Using the different data sources outlined above, the historical, political, social and economic context of India and the development of the accounting framework are outlined in chapters 4 and 5. The changes chosen for analysis are discussed in chapters 6 to 13.

Chapter 4

Culture and the Social, Political and Economic Context of India

Introduction

As discussed in chapter 2, culture has been identified as an important influence on accounting which needs further study. The definition of culture used in this thesis is that found in the anthropological and sociological literature as typified by the definition provided by Kroeber and Kluckhohn, given in chapter 2. *(Kroeber, A.L., and Kluckhohn, C., 1952)*. Under these definitions, culture is seen as acquired behaviour which helps to fulfil the basic needs of man and which helps him to survive in his physical and social environment. Culture is shared by members of a society, is based on symbols and is integrated i.e. all aspects of a culture function as an interrelated whole. *(Haviland, W.A., 1993, chapter 2).* The core of culture is formed by values, which are broad tendencies to prefer certain states over others, *(Hofstede,G., 1980, 1994)* and these values affect the behaviour of man and the institutions, such as the economic and political system, within a society. Both cultural values and social, economic and political institutions within a society also affect the accounting system and accounting change, and are discussed below.

The Cultural and Social Context of India

Universal cultural values

As discussed in chapters 2 and 3, Hofstede identified four universal cultural variables in 1980 and added a fifth in 1990. India was identified as having the following cultural variables:

- large power distance
- strong masculinity
- weak uncertainty avoidance

- weak individualism
- long term orientation

(Hofstede G., 1984; Hofstede G., 1994)

It is expected that these universal cultural values will influence the accounting system in India. In addition to the universal cultural values outlined above, nation specific cultural values and the social, political and economic context, will be important influences on the accounting system in India. The cultural and social values and the economic and political systems of India are discussed below.

The cultural values and social system of India

The main components of the cultural and social system in India are:

- religious and philosophical beliefs
- the family unit and the kinship system
- the caste system

These are discussed below.

Religious and Philosophical beliefs

Religion is closely linked to philosophy in India and provides a social code for Indians to follow on a daily basis and, as such, has a large impact on the daily lives of people in India. The main religion in India is Hinduism but Islam, Jainism, Buddishm, Sikkism and Christianity are all significant minority religions in India. In addition, many tribal religions are also seen in India. *(Heitzman J., 1996 ; Jacobson D., 1996; Ahuja R., 1993; Kuppuswamy B., 1990)*

Hinduism

Within Hinduism, there is much diversity of religious beliefs and there are many traditions, religious texts, schools of thoughts and methods of worship, often arising from criticisms of particular practices, the teachings of Guru's and the

assimilation of practices and beliefs of conquerors (*Heitzman J., 1996; Jacobson D., 1996; Kuppuswamy B., 1990; Sen K.M., 1966; Kingsland V.M., 1997)*

Hindus believe in one god, Brahman, the supreme one. Brahman is divided into three attributes, symbolised by the Trimurti of Brahma the creator, Vishnu the preserver and Shiva the destroyer and Hindus can choose which of the different attributes of Brahman they wish to worship. However in practice, which God one worships often depends on family and caste traditions. (*Heitzman J., 1996; Jacobson D., 1996; Kuppuswamy B., 1990; Sen K.M., 1966; Kingsland V.M., 1997)*

The main religious texts are the Vedas, composed in 1500 BC, of which there are three main collections, the Rig Veda, the Sama Veda and the Yajur Veda. The Rig Veda, in particular, forms much of the basis for Indian religious and philosophical thought. The Upanishads, commentaries on the Vedas generated between about 800 and 200 BC, too are main religious texts in India, and these contain speculations on the meaning of existence which have greatly influenced Indian religious traditions. Other important religious texts are the Ramayan and the Mahabharat. (*Heitzman J., 1996; Jacobson D., 1996; Kuppuswamy B., 1990; Sen K.M., 1966; Kingsland V.M., 1997)*

The religious texts outline fundamental concepts which provide guidance on how Hindus' should live their lives and these concepts include:

- dharma, the observance of moral principles which ensures an individual's happiness and social peace. The moral principles include considerations of righteousness, duty and virtue. Dharma is considered to be the basis of all social and moral order.

- artha, the acquisition of wealth or the means that make life comfortable and ensure the satisfaction of worldly needs.

- kama, the moderate and controlled enjoyment of sensual pleasure.

- moksha, spiritual freedom, salvation and liberation.

(*Heitzman J., 1996; Jacobson D., 1996; Kuppuswamy B., 1990; Sen K.M., 1966; Kingsland V.M., 1997)*

In addition, an individual's life should be split into four stages as follows:

- the first period is called the brahmacharya ashram and covers student life, in which individuals prepare for their future lives.
- the second period is called the grihastha ashram which covers family life and the performance of duties as a householder.
- the third period is called the Vanaprsths ashram in which an individual retires from the life of a householder and devotes himself to the service of society without any idea of accumulating wealth for himself.
- the fourth period is called the sanyasa ashram and is the period in which the individual should give up all worldly pursuits and interests and should devote himself to meditation and yoga.

The stages are observed only notionally by all but a very few Hindus. Of the four ashrams, the grihastha is seen socially to be the most important as the householder sustains the other ashrams. (*Heitzman J., 1996; Jacobson D., 1996; Kuppuswamy B., 1990; Sen K.M., 1966; Kingsland V.M., 1997)*

For most Indians, the most important religious path is that of bhakti (devotion) to a personal god. As outlined above, the Hindu pantheon has three gods at its head, Brahma, the creator, Vishnu, the preserver and Shiva, the destroyer, all three being different facets of the one God, Brahman. Worship (puja) of God consists of a range of ritual offerings and prayers typically performed either on a daily basis or on special days before an image of the deity. (*Heitzman J., 1996; Jacobson D., 1996; Kuppuswamy B., 1990; Sen K.M., 1966; Kingsland V.M., 1997)*

Reincarnation

Hindus believe in reincarnation which is closely linked to the concepts of dharma and karma. Dharma, as outlined above, is a comprehensive doctrine of the duties and rights of an individual in an ideal society. The pursuit of wealth is part of the householder's role, but this is always subject to dharma. Karma is the basis for reincarnation. A person's actions in this life determines his position in the next life and his current position is the result of actions in a past life. Good actions lead to higher positions in the next life and through successive reincarnations, individuals try to achieve moksha (liberation and salvation). Although this belief gives the chance for individuals to improve their position through good actions, the belief also makes an individual helpless regarding his own situation in any particular life and results in a fatalistic attitude and belief in

destiny. (*Heitzman J., 1996; Jacobson D., 1996; Kuppuswamy B., 1990; Sen K.M., 1966; Kingsland V.M., 1997)*

Tolerance and Harmony

Tolerance and harmony are also fundamental postulates of Indian religious and philosophical thought. This leads to religious tolerance, the existence and assimilation of different religions in India and the maintenance of harmony within families, kinship groups and castes. This reinforces secular ideals in India with many different peoples and cultures accommodated within the system. Religious tolerance is also seen at the national level with India being a secular state in which the government has remained independent from any religion, allowing all beliefs equal status before the law. However, there has been a rise in Hindu fundamentalism in India in the 1990's and religious tolerance has not always been practised, in particular between Hindus and Moslems. (*Heitzman J., 1996; Jacobson D., 1996; Kuppuswamy B., 1990; Sen K.M., 1966; Kingsland V.M., 1997)*

The religious and philosophical beliefs discussed above, instil respect for tradition and the following of social and moral codes. Respect for authority, both in following religious texts and the teachings of Gurus, is seen. Mechanisms for dealing with uncertainty such as reincarnation and the observance of social and moral codes of dharma, lead to low uncertainty avoidance and a long term orientation. The religious and philosophical beliefs also support the family structure, as discussed below.

The family system

The members of a single family and their relations with each other make up the family unit which is the basic social unit in India. The most common residential unit is the joint family, usually consisting of three or four patrilineally related generations all living together and co-operating for social and economic benefit. This can, perhaps, be traced back to the rural, agrarian economy in India, in which few individuals could achieve economic security without being part of a strong family group which co-operated together. *(Mandelbaum D.G., 1970, Vol's 1 and*

2; Jacobson D., 1996; Ahuja R., 1993; Kuppuswamy B., 1990; Stern R.W., 1993; Singh Y., 1973; Lannoy R., 1971; Srinivas M. N., 1966)

There is respect for elders and authority, with key decisions made by, usually, the elder males in the family. The decisions include deciding on the education, occupation and marriage partner of the younger members of the family. Not only are there strong kinship ties between immediate members of a joint family, there are also strong kinship ties between members of the extended family and caste members. These kinship ties lead to a complex kinship favour system which includes helping in educating, finding jobs and arranging marriages for younger members of the extended families. Indeed it is not uncommon for relatives to be employed due to this kinship favour system. Within this system, the role of the individual is less important than the family as a whole. *(Mandelbaum D.G., 1970, Vol's 1 and 2; Jacobson D., 1996; Ahuja R., 1993; Kuppuswamy B., 1990; Stern R.W., 1993; Singh Y., 1973; Lannoy R., 197 ; Srinivas M. N., 1966)*

There have been many changes to the village based joint family in India with modernisation and urbanisation. The primary reason for this has been movement to cities in order to gain jobs which leads to smaller family groupings. However, even in these cases, strong networks of kinship ties still exist which are maintained by frequent visits and economic and emotional support at times of family occasions and need. Thus, even with modernisation and urbanisation, the traditional joint family is still the main social unit in India. *(Mandelbaum D.G., 1970, Vol's 1 and 2; Jacobson D., 1996; Ahuja R., 1993; Kuppuswamy B., 1990; Stern R.W., 1993; Singh Y., 1973; Lannoy R., 1971; Srinivas M. N., 1966)*

Social interaction is regarded as being very important in India and family and social bonds last for a long time. All social interactions involve constant attention to hierarchy, respect and rights and obligations and there are cultural rules which help maintain the social relationships between different family members. The most important social bonds are with relatives and these are reinforced at family events and rites. *(Mandelbaum D.G., 1970, Vol's 1 and 2; Jacobson D., 1996; Ahuja R., 1993; Kuppuswamy B., 1990; Stern R.W., 1993; Singh Y., 1973; Lannoy R., 1971 ; Srinivas M. N., 1966)*

Social hierarchy pervades all social life in India. Social hierarchy is formally seen in the caste system, discussed below, but this hierarchy is seen in all aspects of life in India. For example, within families there is a hierarchy, based upon age and sex. Elders are respected by younger members of the family and men are treated as being superior to women. Official position is very important and the basis for prestige. People in higher positions are regarded more highly that people in lower positions and within organisations, junior employees are subordinate and respectful towards senior employees. *(Mandelbaum D.G., 1970, Vol's 1 and 2; Jacobson D., 1996; Ahuja R., 1993; Kuppuswamy B., 1990; Stern R.W., 1993; Singh Y., 1973; Lannoy R., 1971 ; Srinivas M. N., 1966)*

As discussed above, respect for authority and tradition is, once again, seen in the family unit. Within this family unit, the role of the individual is subordinate to the needs of the family and collective decision making is seen, leading to a highly collective society. The main decisions are usually taken by the senior male members of the family, as expected in a society which shows strong masculinity. Hierarchy or high power distance, which is perhaps the most important cultural value in India, is also important within family relationships and is, perhaps, more important than low uncertainty avoidance. Indeed, hierarchy is seen as, perhaps, the most dominant cultural value in India and is the basis for the caste system, which is discussed below.

The Caste system

Castes are ranked, named, endogamous (in-marrying) groups, membership in which is achieved by birth. The word caste derives from the Portuguese word casta which means breed, race or kind and caste is often translated as jati, jat, biradri or samaj. There are many thousands of castes and subcastes in India and each caste is part of a locally based system of interdependence with other castes. Many castes are traditionally associated with, and are linked in complex ways, to networks of caste members all over the country. There is also, often, a link between caste, occupation and economic prosperity. *(Mandelbaum D.G., 1970, Vol's 1*

and 2; Jacobson D., 1996; Ahuja R., 1993; Kuppuswamy B., 1990; Stern R.W., 1993; Singh Y., 1973; Lannoy R., 1971; Srinivas M. N., 1966)

There are four main castes or varna groupings and these can be traced by historians to the Aryan culture in Northern India. The four groupings are:

- Brahmans
- Kshatriyas
- Vaishyas
- Shudras

According to the rig veda, one of the oldest Hindu religious texts, the progenitors of the four ranked varna groups sprang from various parts of the body of primordial man, which were created by Brahma and each had a function in sustaining the life of society. Brahmans or priests were created from the mouth and provided for the intellectual and spiritual needs of society. Kshatriyas, warriors and rulers were derived from the arms and their role was to rule and protect others. Vaishyas, landowners and merchants sprang from the thighs and were entrusted with the care of commerce and agriculture. Shudras, artisans and servants came from the feet and their task was to perform all manual labour. A fifth category was added later, the "untouchables", who were relegated to carrying out very menial and polluting work related to bodily decay and dirt. Untouchables are now often known as scheduled castes, harijans or dalits. Brahmans are at the top of the caste system and untouchables are at the bottom of the caste system. *(Mandelbaum D.G., 1970, Vol's 1 and 2; Jacobson D., 1996; Ahuja R., 1993; Kuppuswamy B., 1990; Stern R.W., 1993; Singh Y., 1973; Lannoy R., 1971 ; Srinivas M. N., 1966)*

Some historians indicate that the caste system was initially a flexible system of functional groups, which led to a division of labour. However, the caste system became more fixed and rigid in the mediaeval period, leading to the caste system seen in India today. *(Mandelbaum D.G., 1970, Vol's 1 and 2; Jacobson D., 1996; Ahuja R., 1993; Kuppuswamy B., 1990; Stern R.W., 1993; Singh Y., 1973; Lannoy R., 1971 ; Srinivas M. N., 1966)*

Though Indian caste society has often been depicted as a static social order, in reality there is some flexibility within the social order, for example whole castes have improved their social position, mainly when they have become economically successful and have challenged and imitated their superiors, a process known as sanskritisation. *(Mandelbaum D.G., 1970, Vol's 1 and 2; Jacobson D., 1996; Ahuja R., 1993; Kuppuswamy B., 1990; Stern R.W., 1993; Singh Y., 1973; Lannoy R., 1971 ; Srinivas M. N., 1966)*

Untouchability has also been made illegal, with the constitution of India including the right to equality and equal protection before the law for all its citizens. Specific laws banning untouchability were also promulgated soon after independence in 1947. However, in practice, the caste system and untouchability still exists and inequality amongst the castes has not been reduced. The problems of the former untouchable class has been addressed by granting them some benefits of protective discrimination for example dalits are entitled to reserved electoral offices, reserved jobs in central and state government and reserved educational benefits. There has, however, been resistance among non-dalits to this protective discrimination for the scheduled castes and backward castes, including special reservation quotas in many jobs. This has not been implemented due to protests by higher caste members whose job opportunities have been reduced by the job reservations for the backward castes. Thus the caste system and caste associations remain important in India today and maintains the inequalities that have always been part of society. *(Mandelbaum D.G., 1970, Vol's 1 and 2; Jacobson D., 1996; Ahuja R., 1993; Kuppuswamy B., 1990; Stern R.W., 1993; Singh Y., 1973; Lannoy R., 1971; Srinivas M. N., 1966)*

The caste system supports the dominance of hierarchy and high power distance within the Indian cultural and social system. As with the family unit, the role of the individual is secondary to the needs of the wider social unit, the caste system, and reinforces the collectiveness of Indian society. Indeed, hierarchy, low uncertainty avoidance, low individualism, high masculinity, respect for tradition and authority and the existence of complex social and moral codes of life, are seen throughout the cultural and social system in India. It is expected that these values will affect the economic and political institutions and system in India,

which in turn influence the accounting system in India. The political and economic institutions and system are discussed below.

An outline of the main elements of the political and economic system in India after independence

The Constitution of India

India gained independence from Britain on 15 August 1947. At this time, the leaders of India wanted to create a modern, prosperous, secular state in which there was equality amongst citizens. They chose to include these ideals in a constitution, which was introduced in 1950. The constitution included fundamental rights such as social, economic and political justice, liberty of expression, including religious expression, and equality of status and opportunity.

In its constitution, India chose a federal structure and a system of parliamentary democracy, in which there was both central government and government by regional states. The central government retained total responsibility for defence, atomic energy, foreign affairs, railways, airways, shipping, post and telegraphs and currency. The states were given responsibility for the police, administration of justice, public health and sanitation, education, agriculture, forests, fisheries, and local government. Responsibility for economic and social planning, trade and commerce, commercial and industrial monopolies and trade unions was shared between central and local government. The parliamentary system is discussed below. *(Kulke H and Rothermund D, 1990, chapter 8 , Spear P., 1990, chapter 19, Wolpert S., 1997, chapter 23., Bakshi P.M., 1995)*

The constitution also gave central government powers to override the states, and also contained an emergency clause, which allowed India's president to suspend the constitution, in the interests of security, for six months at a time. *(Kulke H and Rothermund D, 1990, chapter 8 , Spear P., 1990, chapter 19, Wolpert S., 1997, chapter 23., Bakshi P.M., 1995)*

The parliamentary system

At independence, India chose a parliamentary system similar to the parliamentary system in Britain. Within the parliamentary system in India, Parliament is composed of two houses of parliament, the Lok Sabha, equivalent of the British House of Commons and the Raj Sabha, equivalent to the British House of Lords. The Lok Sabha is the primary house and functions to:

- ensure that the Government is accountable for its actions
- act as a legislative assembly, to promulgate statutory legislation
- act as a representative assembly, where members of parliament represent their constituencies

Members of Parliament are elected to the Lok Sabha at least once every five years and the party with a majority forms the Government. The leader becomes Prime Minister and appoints a cabinet to run the country. The head of state is the President of India but political power is held by the Prime Minister. *(Rogers J.D., 1996, Echeverri-Gent J., 1996, Jain R.B., 1998, Maheshwari S.R. 1998, Bawa P.S. 1998)*

The Raj Sabha is the second chamber. The Raj Sabha also debates legislation and can return legislation to the Lok Sabha for further review, if it disagrees with the legislation as can the House of Lords in Britain.

The role of Parliament as a legislative assembly is the most important for accounting and the full process for promulgating statutory legislation is as follows:

- the appropriate cabinet minister or the prime minister sets up a committee to review the need for legislation
- the appropriate government department drafts a bill to present to the Houses of Parliament
- the cabinet minister then introduces the bill to either the Raj Sabha or the Lok Sabha and the bill is debated in both houses of parliament
- the bill is referred to a committee of the houses of parliament. This committee can be a specially set up joint committee of both houses of parliament or a standing committee of the houses of parliament.
- the committee reviews the bill and makes amendments to the bill. Often, the committees call for written representations from parties interested in the bill and invite witnesses to give oral evidence to the committee.

- amendments to the bill are circulated to all members of parliament or are left on the tables of parliament for inspection
- the bill, as amended by the committee set up to review the bill, is debated in parliament, three times in the Lok Sabha and three times in the Raj Sabha.
- at the end of the debates, the bill is voted upon and, if passed, by both houses of parliament, receives assent from the president of India and becomes law.

(interviews with senior government officials on 10th November 1998 and 17th November 1998; India, a Rogers J.D., 1996 Jain R.B.,1998, Maheshwari S.R. 1998, Bawa P.S. 1998)

This process is used to promulgate all acts of parliament in India and the complete process is used for all major pieces of legislation. However, the process can be shortened for less complex legislation. In these cases, committees are not always set up to review the need for legislation and not all pieces of legislation are reviewed by a committee of the houses of parliament.

The Government

To support the activities of parliament, the Government of India is divided into ministries and departments, which together constitute the central secretariat. The secretariat assists ministers in the formulation of governmental policy, for example in:

- making and modifying polices from time to time
- drafting bills, rules and regulations
- budgeting and controlling expenditure
- supervising the execution of polices
- co-ordination and interpreting policy

(Arora R.K., and Goyal R., 1996, chapter 10; Echeverri-Gent J., 1996)

A typical ministry of the central government is a two-tier structure comprising the political head and the secretarial organisation of the ministry. The political head is the cabinet minister assisted by Minister(s) of State, Deputy Minister(s) of State and the Parliamentary Secretary. The administrative head of the ministry is the Secretary of the Ministry, who is a permanent official. Ministries are then subdivided into departments, each of which is also headed by a

Secretary to the Government, who is usually a permanent official. Under the Secretary of the Department are the posts of Joint Secretary, Director, Deputy Secretary and Under Secretary. All these secretaries are permanent Government officials and over 50% of these posts are filled by members of the Indian Administrative Service (IAS). The ministries of the Government of India are given in appendix 7. *(Arora R.K., and Goyal R., 1996, chapter 10; , Echeverri-Gent J., 1996 ; interviews with senior government officials on 10th November 1998 and 17th November 1998)*

The Department of Company Affairs and the Central Bureau of Direct Taxes

Of the ministries and departments of Government, the Department of Company Affairs (DCA) and the Central Bureau of Direct Taxes (CBDT) are perhaps the most important in relation to accounting in India. The DCA is the main Government department involved in accounting in India and regulates the corporate sector, the Companies Act and all accounting institutions. The DCA has been positioned under the Minister of Finance and the Ministry of Law, Justice and Company Affairs and periodically moves between these two Ministries. *(Arora R.K., and Goyal R., 1996, chapter 10; Echeverri-Gent, 1996)*

The CBDT is responsible for the administration and collection of all direct taxes, including personal taxation and corporate taxation and as such, is also interested in accounting. Tax collection in India has always been complicated and difficult to administer. This has been due to the many differing aims of the tax system. As well as raising revenue, other aims of the tax system have included encouraging savings, promoting investments (particularly in "desired" industries), maximising employment, promoting inter-regional equity and promoting other social objectives.

In addition, both personal income tax and corporate taxation have very narrow tax bases. In the case of income tax, the exclusion of tax on agricultural incomes, administrative difficulties of taxing the unorganised non-agricultural

sector and the provisions of exemptions and deductions for various purposes, leads to less than 1% of the population paying income tax. The corporate tax base is also very narrow, with 96% of tax revenue, coming from 18% of companies, due to generous deductions for depreciation and reinvestment and contributions to a wide variety of social purposes. These problems have led to high average tax rates. For example, income tax rates have been as high as 97% and corporate tax rates have been over 50%. Tax reform has taken place since liberalisation in 1991. The maximum rate of income tax has been reduced to 40%, corporate tax rates have been lowered to below 40% and tax collection has been simplified, which has resulted in an increase in the tax collected. However, the tax base is still very narrow, tax evasion and corruption are widespread and there is still a large black market and these problems still need to be tackled. *(Dewett K.K, Varma J.D. and Sharma M.L.,1995, chapter 45; Kotrappa G., 1996, chapters 1 and 2)*

The corporate structure, industry and stock exchanges in India

The corporate sector in India

The corporate sector in India can be split into four categories as follows:

- a large public sector, which was developed after independence. Public sector enterprises have been mostly inefficient and loss making and are heavily subsidised by the Government.
- an organised private sector comprising of a few large, public companies including complex family run groups and multinational companies and many small and medium business enterprises. Only the very largest companies have contributed to tax revenue since most of the small and medium sector have not operated efficiently, have made losses and/or have entered into tax avoidance schemes
- a large unorganised business sector and black market sector which does not contribute to tax revenue
- a large agrarian sector, most of which is made up of small farmers who are exempt from taxation

(Rogers J.D., 1996; Kotrappa G., 1996, chapters 1 and 2)

The size of the industrial securities market in India has been much smaller than in developed industrialised countries. This has, perhaps, been due to the industrial structure and investment habits in India. In India, the public sector

was, and still is, very large and important. Finance in this sector has always been provided by specialised financial institutions, either government owned or heavily influenced by government. In addition, in the private sector, there are many family run companies and small and medium sized companies who have preferred loan finance rather than equity finance, possibly due to the availability of loan finance at competitive or preferential rates from government institutions and also to retain control of the businesses. *(Krishnan B and Narta S.S., 1998, chapters 1 and 10; Ramesh B., 1996; Batra G.S., 1996; C.B. Gupta, 1996, chapter 2.3; Rogers J.D., 1996)*

Equity has also not been a popular mode of savings for individuals. Less than 1% of all financial assets of the household sector are in the form of shares. This has increased more recently but industrial shares still only account for about 6% of all financial assets in the household sector. In addition to the preference of the corporate sector for loan finance, shares have not been popular with investors due to the structure and criticisms of the stock exchanges in India. The stock exchanges are discussed in the next section. *(Krishnan B and Narta S.S., 1998, chapters 1 and 10; Ramesh B., 1996; Batra G.S., 1996; C.B. Gupta, 1996, chapter 2.3; Rogers J.D., 1996)*

However, equity finance has increased in popularity since independence, boosted by legislation promulgated by the Government. For example, the Foreign Exchange Regulations Act (FERA) of 1974 regulations gave a boost to capital markets with foreign companies diluting their ownership to less than 50% in the 1970's. Liberalisation in licensing and foreign collaborations and government initiatives from such as employee share ownership schemes since the 1980's, too have also increased the popularity of shares. *(Krishnan B and Narta S.S., 1998, chapters 1 and 10; Ramesh B., 1996; Batra G.S., 1996; C.B. Gupta, 1996, chapter 2.3; Rogers J.D., 1996)*

The Stock Exchanges in India

In India, stock exchanges have been organised on a regional basis since before independence. The first stock exchange set up was the Bombay Stock Exchange (BSE), which was set up in 1875 as a member based stock exchange. By 1998, there were 24 recognised regional stock exchanges but the BSE has remained

the largest and most important regional stock exchange with over 70% of the trading business in India undertaken at the BSE. *(Bombay stock exchange, 1998; Rogers J.D., 1996 ; Krishnan B and Narta S.S., 1998, chapters 1,2,3 4, 10, 11, 12 and 13; Ramesh B., 1996; Batra G.S., 1996)*

Before liberalisation, the working of the new issues market in India was regulated by the Controller of Capital Issues (CCI) under the Capital Issues (Control) Act 1947. Companies had to obtain approval from the CCI for all new issues, including approval for the pricing of the securities to be offered. All other stock exchange transactions were regulated directly by the Ministry of Finance. The stock exchanges were also regulated by the Securities Contract (Regulation) Act 1956. The Securities Contract (Regulation) Act 1956, administered by the DCA, was aimed at preventing undesirable transactions and empowered the government to recognise or de-recognise stock exchanges, stipulate rules and by laws for their functioning and to protect the interests of investors. *(Krishnan B and Narta S.S., 1998, chapters 1,2,3 4, 10, 11, 12 and 13; Ramesh B., 1996; Batra G.S., 1996)*

Stock exchanges, themselves regulated by the CCI and the Ministry of Finance, have regulated listed companies since the 1960's by requiring them to follow listing requirements when they list for the first time and annual listing requirements thereafter. The listing requirements have progressively become tighter and are given in appendix 8. *(Krishnan B and Narta S.S., 1998, chapters 1,2,3 4, 10, 11, 12 and 13; Ramesh B., 1996; Batra G.S., 1996)*

Despite these controls, there have been many criticisms of the stock exchanges and these have included delays, lack of transparency in procedures, vulnerability to price rigging, insider trading and the lack of a truly liquid capital market. Indeed there are nearly 8,000 public listed companies on the BSE. Of these, there are a relatively few number of large companies who are actively traded on a daily basis. These comprise of approximately 150 companies, known as A listed companies and these companies are the most economically significant and important companies in India. The other companies on the BSE are classed as B1, B2 and C companies, and there is little activity in the shares of these companies. This has led a lack of liquidity in the stock market which may have deterred small investors. *(Krishnan B and Narta S.S., 1998, chapters 1,2,3 4, 10, 11, 12 and*

13; Ramesh B., 1996; Batra G.S., 1996; interviews with senior representatives of the stock exchanges and SEBI on 2nd November 1998, 5th November 1998 and 6th November 1998)

The criticisms outlined above have led to changes in the regulation of the stock exchanges, mainly after liberalisation in 1991, and have included:

- disbanding of the office of comptroller of capital issues and the control of the stock markets given to Securities and Exchange Board of India (SEBI), which was set up in 1988 and changed into a statutory body by the SEBI Act 1992.
- the setting up of the national stock exchange (NSE) to introduce competition in the capital markets and to serve as a model to other stock exchanges.

SEBI, is headed by a statutory board of 6 members representing the Government, the Reserve Bank of India and the stock markets, and has powers to control and regulate stock exchanges. The objectives of SEBI are to:

- protect the interests of investors, so that, there is a steady flow of saving into the capital markets
- promote the development of securities markets
- promote efficient services by brokers, merchant bankers and other intermediaries
- regulate the securities markets and ensure that fair practices by the issuers of securities, so that they become competitive and professional

SEBI has issued many guidelines on the primary and secondary markets and has also strengthened the stock exchange listing requirements The stock exchange listing requirements are given in appendix 8. *(Krishnan B and Narta S.S., 1998, chapters 1,2,3 4, 10, 11, 12, 13 and 15; Ramesh B., 1996; Batra G.S., 1996; interviews with senior representatives of the stock exchanges and SEBI on 2nd November 1998, 5th November 1998 and 6th November 1998)*

These changes have led to many medium sized companies who previously obtained funds from banks and financial institutions issuing shares on the stock markets and both the number of issues and funds raised on the stock exchanges has increased since liberalisation. Until 1996, the capital markets were buoyant but a downturn in activity was seen in 1997 and 1998, possibly due to political uncertainties leading to the slowing down of liberalisation measures and a

downturn in the economy. *(Aiyar V.S. and Rekhi S., 24th August 1998; Chakravorty S. and Aiyar V.S., 1st June 1998; Rekhi S., 8th June 1998)*

A brief outline of the key political and economic polices and institutions has been outlined above, focusing on institutions which are most likely to influence accounting. In addition to this, a brief outline of key developments and issues in the political and economic systems of India since independence is given below, as these are expected to influence the accounting system and accounting change.

The Politics and Economics of India since independence

The British legacy at independence

India gained independence in 1947 from the British, after a long period of colonisation. The economy inherited by India at independence was in a very poor state, due to the colonial policies of Britain. During the period of colonisation, the economy of India had been run in the interests of Britain. For example, under polices made in Britain, India produced raw materials and foodstuffs which were exported to Britain and Britain manufactured goods using the raw materials which were exported back to India. This import/export policy, which left India as a supplier of raw materials to the British and as a market for British goods, was very much in the interests of the British economy. India was left with a predominantly agrarian economy using low productivity methods with little use of fertilisers and irrigation to improve output. *(Joshi V and Little I.M.D., 1994, chapters 1 and 3; Kumar K, 1970, chapter xiii; Rothermund R, chapters 9 and 10; Rogers J.D., 1996,; Chandra B, 1992)*

Foreign capital dominated industry in India with British firms dominating, either directly or through managing agencies. British policy was believed to have been responsible for a decline in indigenous industry. Some Indian family based companies such as the Tata group and the Birla group ran successful businesses, for example in iron and steel and textiles but these were insignificant in comparison to British run companies. At independence, what little Indian industry there was, produced low technology, low productivity, low wage and

labour intensive goods and was concentrated in only a few selected areas such as textiles. There was little production of capital goods and a lack of infrastructure industries, modern banking and insurance. *(Joshi V and Little I.M.D., 1994, chapters 1 and 3; Kumar K, 1970, chapter xiii; Rothermund R, chapters 9 and 10; Rogers J.D.,1996; Chandra B, 1992)*

India's economy was very underdeveloped with low per capita income, poor economic growth, many living under the poverty line and little industrialisation. Indeed, under the British, most of the economic surpluses generated by India had been exported back to Britain or spent on British administration and the British army, with little or no equivalent transfer back to India. *(Joshi V and Little I.M.D., 1994, chapters 1 and 3; Kumar K, 1970, chapter xiii; Rothermund R, chapters 9 and 10; Rogers J.D, 1996; Chandra B, 1992)*

India did also inherit some advantages at independence. These included both tangible and intangible assets. Tangible assets included a national transport system, some development projects (such as food growing and irrigation projects) and some reserves of foreign exchange. Intangible assets included an established political party, the Indian National Congress (INC), which had gained much experience while opposing the British rule of India, an attitude of monetary and fiscal conservatism, and an administrative apparatus to run the institutions in India after independence. *(Joshi V and Little I.M.D., 1994, chapters 1 and 3; Kumar K, 1970, chapter xiii; Rothermund R, chapters 9 and 10; Rogers J.D., 1996; Chandra B, 1992; Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8; Spear P., 1978, chapters 19 to 21)*

In addition, many of the political and economic institutions that are seen in India today, were in place at independence or were set up very quickly after independence. The political system adopted by India was a cabinet style Government led by a Prime Minister, similar to the political system of Britain. India also chose a financial system similar to that of the British, with a banking system based along British lines and a Reserve Bank, which was nationalised soon after independence. *(Joshi V and Little I.M.D., 1994, chapters 1 and 3; Rothermund R, 1993, chapters 9 and 10; Rogers J.D., 1996; Chandra B, 1992)*

However, on the whole, India had many economic and social problems to tackle at independence and the economic policies that India implemented at independence, including central planning, development of large public sector and a controlled private sector, were intended to tackle these problems. The economic system that was implemented soon after independence operated with little change until 1991. In 1991, the economy was in crisis and the Government of the time, decided to move away from a planned economy and undertook measures to liberalise the economy. The development of the political and economic systems of India after independence is discussed below.

Politics and Economics from 1947 to 1960

Jawarharlal Nehru and Sardar Vallabhbhai Patel at independence

At independence, India was partitioned into Pakistan and India and this led to a large and violent migration of people from India to Pakistan and from Pakistan to India. The stopping of this violence and the resettling of the large numbers of refugees who came to India became the first problem that India had to deal with as an independent nation. Other problems that also needed tackling were economic and social development, equity between the different stakeholders in society and the fairer distribution of wealth, eradication of poverty and creating one nation out of all the different regions and different communities existing in India. *(Kumar K, 1970, chapter xiii; Rothermund R, chapters 9 and 10; Rogers J.D., 1996; Chandra B, 1992; Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8; Spear P., 1978, chapters 19 to 21)*

These problems were tackled by the Indian National Congress under the leadership of Jawaharlal Nehru and Sardar Vallabhbhai Patel. The Indian National Congress (INC) had been one of the main organisations in the fight for independence and had had a broad social base. After independence, the Indian National Congress became a major central political party, the Congress party, retaining its broad social base by appointing Nehru, who represented the left wing of the congress, as Prime Minister and Patel, who represented the right wing of the congress and the business community, as vice president and home

affairs minister. *(Joshi V and Little I.M.D., 1994, chapters 1 and 3; Kumar K, 1970, chapter xiii; Rothermund R, chapters 9 and 10; Rogers J.D., 1996; Chandra B, 1992; Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8; Spear P., 1978, chapters 19 to 21)*

Mahatma Gandhi, a key figure in the independence fight, did not have an official post in the party but was instrumental in restoring peace during the violence which accompanied independence and partition. In January 1948, Gandhi, fasted for peace and this fasting led to a cessation of violence between Hindus and Muslims. Soon after this, on 30th January 1948, fanatical Hindu fundamentalists, who considered that too much favour was being given to the Muslims, assassinated Gandhi. This shocked the whole nation and unleashed a backlash against Hindu fundamentalists, which helped the leaders of the Congress party to create a secular state. *(Joshi V and Little I.M.D., 1994, chapters 1 and 3; Kumar K, 1970, chapter xiii; Rothermund R, chapters 9 and 10; Rogers J.D., 1996; Chandra B, 1992; Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8; Spear P., 1978, chapters 19 to 21)*

Nehru and Patel worked together until Patel's death in 1950 to create modern India. Nehru became involved in economic development, social reform and foreign affairs and Patel united India by negotiating or forcing all the princely states to accede to the nation. This included accession by Kashmir, which was never fully accepted by Pakistan and is still a major source of conflict between India and Pakistan today. *(Joshi V and Little I.M.D., 1994, chapters 1 and 3; Kumar K, 1970, chapter xiii; Rothermund R, chapters 9 and 10; Rogers J.D., 1996 ; Chandra B, 1992; Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8; Spear P., 1978, chapters 19 to 21)*

- **Jawarhalal Nehru**

After the death of Patel, Nehru dominated the politics of India and ruled as Prime Minister until his death in 1964. Nehru was a western educated Fabian socialist with Marxist tendencies who held strong beliefs on economic development, social welfare and reform and foreign affairs. The Nehru initiated reforms in these areas are discussed below.

Economic development

Despite his Marxist tendencies, Nehru did not lead India towards communism. Instead he introduced a mixed economy into India, in which there was a role for both private and public enterprise and in which socialist ideals were operated within a secular democracy.

The key elements of the economic system that were implemented soon after independence included central planning of the economy, the development of a large public sector, control and licensing of private enterprise, the use of import substituting policies and state control of foreign investment. These are discussed below. *(Joshi V and Little I.M.D., 1994, chapters 1 and 3; Kumar K, 1970, chapter xiii; Rothermund R, 1993, chapters 9 and 10; Rogers J.D., 1996, chapter 6; Chandra B, 1992; Dandekar V.M., 1992; Mohan R., 1992; Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8; Spear P., 1978, chapters 19 to 21; Brass P., 1994, chapters 8 to 10; Brown J., 1994, chapter vii; Dewett K.K., Varma J.D. and Sharma M.L., 1995)*

Central Planning and the public sector

Central planning of the economy was implemented very quickly after independence. A resolution on Industrial policy, issued on 6th April 1948, stated that the aim of the Government of independent India was to establish a social order where justice and equality of opportunity would be secured for all people. This would be achieved by careful planning over the whole of the economy and a National Planning Commission (NPC) was set up, under the chairmanship of Jawarharlal Nehru, to advise on central planning using five year plans, based on the Soviet model. *(Joshi V and Little I.M.D., 1994, chapters 1 and 3; Kumar K, 1970, chapter xiii; Rothermund R, 1993, chapters 9 and 10; Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8; Spear P., 1978, chapters 19 to 21; Brown J., 1994, chapter vii; Dewett K.K., Varma J.D. and Sharma M.L., 1995, chapter 50)*

In total, seven five year plans were prepared from 1951 to 1990. The target growth rates in all the five year plans were between 5% and 5.5% and all specified targets for investment in both the public and private sectors. Later plans included foreign aid requirements and agricultural targets. The five year

plans focused on developing heavy industry in the public sector. A second industrial policy resolution, issued on 30th October 1956, divided industries into three groups. The first group were industries which would be in the public sector and included defence, heavy industry, most mining, aircraft, air transport, rail transport, communications and power. Existing businesses were not nationalised but all future projects in these areas were to be in the public sector. The second group were industries which were to be in both the public sector and the private sector. The idea was that the state would establish undertakings in these industries and private enterprise would supplement the public sector initiatives. The third category included all other industries for example most consumer good industries and these were to be left to the private sector. The private sector is outlined in the next section. *(Joshi V and Little I.M.D., 1994, chapters 1 and 3; Kumar K, 1970, chapter xiii; Rothermund R, 1993, chapters 9 and 10; Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8; Spear P., 1978, chapters 19 to 21; Brown J., 1994, chapter vii; Dewett K.K., Varma J.D. and Sharma M.L., 1995, chapter 50)*

The public sector in India is an important part of the economy and controls a large proportion of assets, though the number the public sector of enterprises is much lower than the number of private sector enterprises. However, the public sector has not performed well with most public sector enterprises operating inefficiently, making losses and having to be heavily subsidised by the Government.

The private sector, licensing and other trade controls

The industries left to the private sector, mostly consumer goods industries, were regulated by the Industries Development and Regulation (IDR) Act of 1951. This gave the Government powers to regulate and control specified industries and this was done through a licensing system. Initially, the licensing system was implemented to control and promote a few selected industries and all import and export trade. However, in practice, the licensing system was used to control almost all industries. *(Joshi V and Little I.M.D., 1994, chapters 1 and 3; Kumar K, 1970, chapter xiii; Rothermund R, 1993, chapters 9 and 10; Rogers J.D.,1996; Chandra B, 1992; Dandekar V.M., 1992; Mohan R., 1992; Wolpert S., 1997, chapters 23 to 26; Kulke H and*

Rothermund D, 1995, chapter 8; Spear P., 1978, chapters 19 to 21; Dewett K.K., Varma J.D. and Sharma M.L., 1995, chapter 21)

In addition to licensing, the State imposed import controls and foreign exchange controls and chose to encourage import substituting policies, which gave protection to indigenous business. The private sector benefited from protective tariffs and prohibition of imports, which led to low quality goods being produced by many private industrialists. The lack of competition meant that these low quality goods could be sold at high prices and the private sector was able to make large profits. *(Joshi V and Little I.M.D., 1994, chapters 1 and 3; Rothermund R, 1993, chapters 9 and 10; Chandra B, 1992; Dandekar V.M., 1992; Mohan R., 1992; Spear P., 1978, chapters 19 to 21)*

Price controls were also introduced to try and control the prices of a range of commodities. The objectives of administered prices was to provide poorer groups with certain basic necessities at low prices, to provide key inputs for the development process at low prices, to encourage the use of certain commodities such as fertilisers and to control inflation. However, in practice, the effect of the trade controls was again to protect Indian industry and led to shortages of commodities, low profitability, lack of modernisation, high costs, mounting government subsidies and an active black market. *(Joshi V and Little I.M.D., 1994, chapters 1 and 3; Kumar K, 1970, chapter xiii; Rothermund R, 1993, chapters 9 and 10; Rogers J.D., 1996; Wolpert S., 1997, chapters 23 to 26; Spear P., 1978, chapters 19 to 21)*

State control of foreign interests

Foreign investment in India after independence was needed but India feared that, if not controlled, this might lead to foreign interests running businesses in India for their own benefit. State control of foreign capital and foreign investment was therefore considered very important by India. In addition, India also entered into polices which protected Indian businesses from international competition. These included import restrictions, high tariffs, import substitution and production for the domestic market rather than for exports. Indeed as time progressed, foreign interests were subject to more and more controls. In particular, foreign interests

and investments were regulated by the Foreign Exchange Regulation Act (FERA) 1974 which prohibited foreign ownership and management of companies and which led to foreign companies reducing their share ownership of companies to below 50%. The Act also prohibited foreign control over key areas of the economy such as banking, insurance, machinery, chemicals and petroleum. Since liberalisation, controls over foreign exchange controls have been reduced and foreign investments have been encouraged. *(Joshi V and Little I.M.D., 1994, chapters 1 and 3; Rothermund R, 1993, chapters 9 and 10; Rogers J.D., 1996; Kulke H and Rothermund D, 1995, chapter 8; Spear P., 1978, chapters 19 to 21)*

Social Reform

Social reform also took place under Nehru, with the outlawing of untouchability introducing quotas for ex-untouchables in government services and the passing of laws improving the rights of women in Hindu Succession Act (1955) and the Hindu Marriage Act (1956). The Hindu succession Act gave women equal rights with men in the matter of succession to property and the Hindu Marriage Act gave women protection and rights in marriage and divorce. These reforms were opposed by many members of the Congress party and social reform is an ongoing issue. Indeed, the legislative reforms have had only limited success in practice since, arguably, they went against fundamental cultural and social values in India such as hierarchy, masculinity, collectivism and the caste system, as discussed above.

At independence, social indicators were poor with low life expectancy, high child mortality, low adult literacy and a large number of people living in poverty. Some improvements have been seen for example in mortality rates and life expectancy in the fifty years since independence. However, adult literacy is still low and population growth continues to be high (around 2% in the period 1980 to 1992) leading to social problems and continuing poverty for a large number of people. Social reform, particularly in the areas of population growth, health and education is still needed in the late 1990's. Indeed, it has been argued, for example by Dreze and Sen, that economic reforms in the 1990's will only increase inequality and will not be successful in the long term, unless economic

reform is combined with social reform. *(Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8; Spear P., 1978, chapters 19 to 21; Dreze and Sen, 1996)*

Foreign Affairs

Nehru was also in charge of foreign affairs. Nehru's principles, which guided foreign policy, were national independence, anti-colonialism, internationalism and non-alignment with any world power. Nehru managed to remain independent of both the Soviet Union and the United States of America, although he was friendlier towards the Soviet Union than the United States. The main problems that Nehru had to deal with in the 1950's related to Pakistan and included issues such as sharing of assets between India and Pakistan, the settlement of refugee property and the state of Kashmir. *(spear chapter 20).* In addition, in the 1950's Nehru negotiated the panchshila agreement with China which included non aggression, non- interference in each others internal affairs, mutual respect for each others sovereignty and territorial integrity, equality and mutual benefit and peaceful co-existence. *(Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8; Spear P., 1978, chapters 19 to 21)*

On the whole, the 1950's were years of relative success for India, with democratic government instituted and economic and social reform started. The period was dominated by Nehru and the Congress party but minority parties, for example the communist parties on the left and the swantantra parties on the right, were listened to and had a part to play in Parliament. *(Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8; Spear P., 1978, chapters 19 to 21; Brass P., 1994, chapters 8 to 10; Brown J., 1994, chapter vii)*

However, despite initial optimism for strong economic growth in the early 1950's, India started to face many problems in the economy from the late 1950's onwards. In the late 1950's, there was deterioration in the balance of payments which led to India needing foreign aid, which was explicitly included for the first time in the third five year plan.

Politics and Economics in the 1960's

Nehru and Lal Bahdur Shastri

The 1960's were not as successful as the 1950's. Border disputes had taken place in 1955 and 1957 between India and China and finally in 1962, China entered India, despite the panchshila agreement. War was only prevented by a unilateral cease-fire by China and this was a blow for Nehru. who had negotiated the panchshila agreement with China. Nehru did not survive for much longer and died in 1964. *(Paul J.J., 1996; Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8; Spear P., 1978, chapters 19 to 21; Brass P., 1994, chapters 8 to 10; Brown J., 1994, chapter vii)*

After Nehru's death on 27th May 1964, Lal Bahadur Shastri became Prime Minster. Shortly after taking over as Prime Minister, conflict with Pakistan broke out when Pakistan crossed into India and this led to a war in September 1965. The war was won quickly by India and at the end of the conflict, Russia convened a conference at Tashkent to help discuss the problems between India and Pakistan. At this conference, Lal Bahadur Shastri signed an agreement with Pakistan which was generally considered to be a promising treaty that might lead to long term resolution of the problems with Pakistan. Unfortunately Lal Bahadur Shastri died of a heart attack at the end of the Tashkent conference and the peace treaty with Pakistan was never implemented. *(Paul J.J., 1996; Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8; Spear P., 1978, chapters 19 to 21; Brass P., 1994, chapters 8 to 10; Brown J., 1994, chapter vii)*

Indira Gandhi

The death of Lal Bahadur Shastri ended the dominance of politics by the Congress party. There was no obvious leader of the Congress party and there followed a struggle for the leadership of the Congress party between Moraj Desai, who represented the right wing of the party, and Indira Gandhi, the daughter of Jawarhalal Nehru, who represented the left wing of the party. The Congress party was split in this struggle, which was won by Indira Gandhi. Indira Gandhi became the leader of Congress party and the Prime Minister of

India in 1965. Moraj Desai was given the post of Deputy Prime Minister to try and unite the Congress party and retain its broad social base. Like her father, Indira Gandhi believed in socialism and supported the use of central planning, rapid industrialisation and the development of a large public sector. *(Paul J.J., 1996; Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8; Spear P., 1978, chapters 19 to 21; Brass P., 1994, chapters 8 to 10; Brown J., 1994, chapter vii)*

Indira Gandhi had many problems to deal with early on as Prime Minister. In her first year as Prime Minister she had to deal with a tribal uprising in Nagaland. In addition, the economy had been left in a poor state after Lal Bahadur Shastri's death. The wars with China and Pakistan had increased public expenditure significantly and this was compounded by droughts in 1965, 1966 and 1967, which reduced agricultural output. *(Joshi V and Little I.M.D., 1994, chapters 1 and 3; Kumar K, 1970, chapter xiii; Rothermund R, 1993, chapters 9 and 10; Rogers J.D., 1996; Paul J.J.,1996; Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8; Spear P., 1978, chapters 19 to 21; Brass P., 1994, chapters 8 to 10; Brown J., 1994, chapter vii)*

During this time, inflation increased significantly, fiscal deficits were seen and balance of payments deteriorated. India had to rely on foreign aid and loans, particularly a loan from the USA. These loans were not without cost. India was forced to devalue the rupee in 1966, rationalise its system of controls, focus on agricultural issues and adopt restrictive fiscal polices, in return for the loans. India's economy did improve a little in the late 1960's, helped by a green revolution with increased agricultural output due to the use of high yielding seeds. However, industry was stagnating with outdated technology, the public sector was not performing well, exports had not been stimulated by the devaluation of the rupee, imports had become more expensive and inflation increased. In addition, the population continued to grow at a rate of over 2% per annum and a large sector of the population still lived in poverty. *(Joshi V and Little I.M.D., 1994, chapters 1 and 3; Kumar K, 1970, chapter xiii; Rothermund R, 1993, chapters 9 and 10; Rogers J.D.,; Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8; Spear P., 1978, chapters 19 to 21; Brown J., 1994, chapter vii)*

Indira Gandhi was perceived to be a weak leader and was criticised for her handling of the economy and the devaluation of the rupee. This led to Congress performing poorly in the 1967 elections, despite some improvements in agriculture in the late 1960's. Indira Gandhi and the Congress party won the 1967 election with only a small majority of 20 seats in Parliament and retained control of only eight of the sixteen state assemblies. *(Paul J.J., 1996; Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8; Spear P., 1978, chapters 19 to 21; Brass P., 1994, chapters 8 to 10; Brown J., 1994, chapter vii)*

Indira Gandhi continued to govern the country in coalition with other parties until 1969. However the government was not stable and there was continued friction within the Congress party between Indira Gandhi and Moraj Desai. Eventually, in 1969, Moraj Desai was removed as deputy prime minister and Indira Gandhi implemented a policy of nationalising of banks, which was against the views of the right wing of the party. This led to the expulsion of Indira Gandhi from the Congress party and led Indira Gandhi to set up her own Congress party, Congress (R). She managed to win the support of a majority of members of parliament and was able to form a left wing coalition government with the communist party and regional parties. *(Paul J.J., 1996; Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8; Spear P., 1978, chapters 19 to 21; Brass P., 1994, chapters 8 to 10; Brown J., 1994, chapter vii)*

From this point the Congress party lost the broad social appeal that it had had at independence and under Jawarhalal Nehru and became dominated by the Gandhi family. In fact, during her period as Prime Minister, politics in India became personality based, rather than issues based and the democratic institutions became weakened. The party lost its ability to react to local conditions through the appointment of local candidates. Instead, party candidates were chosen by Indira Gandhi and subsequent leaders, often in reward for loyalty, but this resulted in candidates who had little knowledge of the areas they represented. *(Paul J.J., 1996; Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8; Spear P., 1978, chapters 19 to 21; Brass P., 1994, chapters 8 to 10; Brown J., 1994, chapter vii)*

Politics and Economics in the 1970's

Indira Gandhi and the emergency

The next elections were held in March 1971, and these were won by Indira Gandhi and her Congress party, with a landslide victory, due to weak opposition, a green revolution increasing food yields and the promise to remove poverty in India. *(Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8; Spear P., 1978, chapters 19 to 21; Brass P., 1994, chapters 8 to 10; Brown J., 1994, chapter vii)*

After the election, conflict between West and East Pakistan started with West Pakistan arresting the leaders of East Pakistan, who were demanding independence and firing on the citizens of East Pakistan. During these troubles, over eight million people fled to India as refugees, creating an economic burden for India, in feeding and housing these refugees. India finally went to war with West Pakistan in December 1971. This war was won by India and led to the independence of East Pakistan, which was renamed Bangladesh, and the repatriation of all the refugees who had fled to India, back to Bangladesh. *(Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8; Spear P., 1978, chapters 19 to 21; Brass P., 1994, chapters 8 to 10; Brown J., 1994, chapter vii)*

The war between India and Pakistan led to an increase in inflation which rose further in 1973 when OPEC countries quadrupled their oil prices. India was very dependent on imports of oil and the steep increase in oil prices led to rates of inflation of around 25%. Industry continued to stagnate, leading to high unemployment in the country. This led to concerns for:

- job creation,
- increasing economic efficiency, output and performance,
- modernisation, research and development, the use of new technology and professional management in the corporate sector,
- control of corporate sector abuses and related party transactions
- foreign exchange control
- stimulating exports, controlling imports and promoting the use of indigenous materials
- the concentration of economic wealth.

It was generally perceived that these were areas which needed prioritising in order to stimulate economic development and growth. *(Joshi V and Little I.M.D., 1994, chapters 1 and 3; Rothermund R, 1993, chapters 9 and 10; Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8; Spear P., 1978, chapters 19 to 21; Brass P., 1994, chapters 8 to 10; Brown J., 1994, chapter vii)*

These economic and social problems led to controls over the economy being increased even further. A program of nationalisation took place with banks nationalised in 1969, insurance nationalised in 1972 and the coal industry nationalised in 1973. The Government took over the management of many "sick" companies, the Monopolies and Restrictive Trade Practices (MRTP) Act was promulgated in 1969 and the Foreign Exchange Regulation (FERA) Act was promulgated in 1974. *(Joshi V and Little I.M.D., 1994, chapters 1 and 3; Rothermund R, 1993, chapters 9 and 10; Rogers J.D., 1996; Spear P., 1978, chapters 19 to 21)*

The MRTP Act regulated the concentration of economic power and anti-competitive pressures perceived to be a problem in socialist India. Under the Monopolies and Restrictive Practices Act, 1969 (MRTP) firms with assets above a certain threshold or with a dominant market position were required to obtain clearances before expanding or entering new markets. MRTP clearances usually took up to two years and thresholds have not increased over time, hence becoming more and more restrictive. The effect of MRTP regulations has been to limit the growth of large firms, prevent economies of scale and limit expenditure on research and development. In many cases, competition has been reduced, rather than increased. The FERA Act 1974 regulated foreign investments and interests in India, prohibited foreign ownership and management of companies and prohibited foreign control over key areas of the economy, as outlined earlier in the chapter. *(Joshi V and Little I.M.D., 1994, chapters 1 and 3; Rothermund R, 1993, chapters 9 and 10; Rogers J.D.,1996; Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8; Spear P., 1978, chapters 19 to 21)*

Despite these actions, the economy did not improve and there was widespread civil unrest in India. There were food riots, student protests, industrial strikes and assassinations and attempted assassinations of government ministers and officials. In addition, there were increasing criticisms of inefficiency and

corruption in the Government. Indira Gandhi herself was accused of election malpractice, in 1975, in the Allahabad High Courts. The Courts found against Indira Gandhi and the conviction carried a penalty of preventing her from running for, or holding office, for six years. There were calls for Mrs Gandhi's resignation and it seemed unlikely that, even if elections were held, Indira Gandhi would be re-elected. *(Paul J.J., 1996; Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8; Spear P., 1978, chapters 19 to 21; Brass P., 1994, chapters 8 to 10; Brown J., 1994, chapter vii)*

Instead of resigning or holding elections, Mrs Gandhi declared a state of emergency, using powers available under the constitution to declare emergencies on the grounds of national security. During the period of emergency, the economy improved with tight fiscal policy, short term foreign aid and remittances from non-resident Indians working in the Middle East. However, civil rights such as freedom from arrest without trial, freedom of speech and the independence of the High Courts were curtailed. In addition, sterilisation programs run by Indira Gandhi's son, Sanjay Gandhi, were introduced, and many people were forced to have sterilisations to try and stop the rapid growth of population which had negated any economic success. All this proved to be very unpopular and contributed to the defeat of Indira Gandhi in 1977 when the emergency was lifted and elections held. Opposition political leaders had been jailed during the emergency and were released only weeks before the election. Despite this, the opposition parties managed to organise themselves quickly and entered into an alliance, which defeated Indira Gandhi *(Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8; Spear P., 1978, chapters 19 to 21; Brass P., 1994, chapters 8 to 10; Brown J., 1994, chapter vii)*

Coalition from 1978 to 1980

Once elected, the opposition party, after much difficulty and negotiation, chose Moraj Desai as Prime Minister, with Charan Singh as deputy. Atul Bihari Vajpayee and Lal Advani took two cabinet posts. These two were to become important leaders of the Bhartya Janata party in the 1990's. Moraj Desai was not a successful leader and spent time on irrelevant issues such as banning alcohol

and beef, rather than tackling rising unemployment, high inflation, industrial stagnation, increasing urban violence, inadequate housing, black markets and tax evasion. Food stores and foreign exchange were quickly used up and there was disagreement between Moraj Desai, his deputy and other coalition members. In 1979, Charan Singh resigned and this, in turn, led to the resignation of Moraj Desai. Another coalition was formed, headed by Charan Singh, who became the Prime Minster of a minority government. This government only lasted a few months and elections were called in 1980. These elections were won by Indira Gandhi and her congress party, against most expectations, due to allegations of corruption, incompetence and quarrelling within the coalition government. *(Joshi V and Little I.M.D., 1994, chapters 1 and 3; Kumar K, 1970, chapter xiii; Rothermund R, 1993, chapters 9 and 10; Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8; Spear P., 1978, chapters 19 to 21; Brass P., 1994, chapters 8 to 10; Brown J., 1994, chapter vii)*

Politics and Economics in the 1980's

Indira Gandhi and Rajiv Gandhi from 1980 to 1988

After the 1980 election, Indira Gandhi tried to consolidate her power by eliminating state governments who were run by opposition parties, with success in some areas and failure in other cases. Regional unrest also caused problems in Assam and Punjab. Punjab proved to be the biggest problem for Indira Gandhi. In Punjab, Sikh terrorists, led by Jarnail Singh Bhindranwale, were demanding a separate Sikh state. President's rule was imposed in Punjab in 1983, when Bhindranwale, based himself and his group at one of the most important religious sites for Sikhs, the Golden Temple in Amritsar. In June 1984, Indira Gandhi ordered the Golden Temple to be stormed by the Indian army and in this action, Bhindranwale was killed. In retaliation, Indira Gandhi was assassinated by her Sikh bodyguard on 31 October 1984, just before elections were due. *(Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8; Brass P., 1994, chapters 8 to 10; Brown J., 1994, chapter vii; Dewett K.K., Varma J.D. and Sharma M.L., 1995)*

With Indira Gandhi's death, her son, Rajiv Gandhi, at the request of the Congress party, became leader of the Congress party and fought the general election in 1985, winning a landslide victory and gaining 400 out of 500 Lok Sabha seats. Rajiv Gandhi was known as "Mr Clean" and was initially removed from the corruption of the previous administrations. Rajiv Gandhi made a promising start in tackling India's regional unrest and economic problems. He negotiated accords with Assam and Punjab, which helped to stop violence and led to state elections in both regions. He initiated the setting up of the South Asian Association for Regional Co-operation, (SAARC) which was set up to foster regional co-operation and relations, in particular with Pakistan. In December 1985, India also became involved in the problems in Sri Lanka between the singhalese community and the tamil population, with India providing army support to the Government of Sri Lanka against the tamil tigers in 1987. *(Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8; Brass P., 1994, chapters 8 to 10; Brown J., 1994, chapter vii)*

Rajiv Gandhi was not a socialist and did not believe in centralised planning and together with his finance minister, V.P. Singh, entered into economic polices which started to liberalise the economy. These included:

- some dilution of licensing requirements
- some reduction in restrictions on imports of capital goods to encourage technological modernisation
- some increase in incentives for exports
- a policy of active exchange rate depreciation
- a reduction in the rates of direct taxation to increase incentives and reduce evasion

(Joshi V and Little I.M.D., 1994, chapters 1 and 3; Rothermund R, 1993, chapters 9 and 10; Rogers J.D., 1996; Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8)

Major economic concerns in the 1980's were the liberalisation of the economy, simplification of regulations and the protection of the investing public. In addition, rapid economic growth was, as always, an important focus and particular problems which had arisen mainly in the 1970's, such as foreign exchange problems, energy crises and the modernisation of the corporate sector, still needed to be addressed.

The measures, outlined above, started to reverse the inefficient, protected, highly regulated economy of India, which had developed since the 1950's. Improvements in the economy were seen. Steady industrial growth occurred in the 1980's, in contrast to the industrial recession of the 1970's, with economic growth between 6-8% of GDP per annum, double the previous economic growth rates which had been around 3.5%. Both industrial production and agricultural output increased with a reduction in licensing, the use of modern technology and more irrigation projects. *(Joshi V and Little I.M.D., 1994, chapters 1 and 3; Rothermund R, 1993, chapters 9 and 10; Rogers J.D., 1996)*

Despite a promising start, not all economic problems were addressed. Current account deficits and balance of payment deficits were not tackled and public borrowing remained high. In addition, Rajiv Gandhi fell out with V.P. Singh, his finance minister and forced him to resign in 1987. He was also not able to implement political accords signed with Assam and Punjab and was accused of corruption in relation to arms deals with a Swedish company called Bofors. All these issues were important factors in the 1988 elections, in which no single political party gained a majority. *(Joshi V and Little I.M.D., 1994, chapters 1 and 3; Rothermund R, 1993, chapters 9 and 10; Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8; Spear P., 1978, chapters 19 to 21; Brass P., 1994, chapters 8 to 10; Brown J., 1994, chapter vii)*

Coalition Governments from 1988 to 1991

In 1988, Rajiv Gandhi decided to hold a general election, the result of which was a hung parliament. The congress party was the majority party but was unable to form a government as the other parties refused to form a coalition with them. The first coalition government was formed by V.P. Singh but this soon fell apart due to rivalries between V.P. Singh and other members of the coalition, mainly on the issue of Hindu fundamentalism, reservations for backward castes and the issue of Ramjanmabhumi. Ramjanmabhumi related to the opposition to the Babari mosque which had been built at Ayodhya, on the site of a temple which was perceived to be the birth place of one of Hinduism's main gods, Rama.

(Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8; Brass P., 1994, chapters 8 to 10; Brown J., 1994, chapter vii)

Another minority government was formed by Chandra Shekur, which lasted until February 1991 when it was toppled by Rajiv Gandhi and elections were set for May 1991. Just before polling day, Rajiv Gandhi was assassinated by terrorists connected to the Sri Lanka situation The leadership of the party was offered to Sonia Gandhi, Rajiv Gandhi's Italian wife, who at that time declined to enter politics. Sonia Gandhi later changed her mind and became involved in politics in the 1990's. The leadership of the Congress party was then offered to P.V. Narasima Rao, who had been Foreign Minster under both Indira and Rajiv Gandhi. Elections went ahead and Congress did better than expected. *(Joshi V and Little I.M.D., 1994, chapters 1and 3; Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8; Brass P., 1994, chapters 8 to 10; Brown J., 1994, chapter vii)*

Politics and economics since 1991

P.V. Narasima Rao was a long term believer in the secular ideas of Nehru and was able to form a minority government with the communist party. One of the first things that Narasima Rao and his finance minister, Dr Man Mohan Singh, had to tackle was a major economic crisis. *(Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8; Brass P., 1994, chapters 8 to 10; Brown J., 1994, chapter vii)*

India was in a critical position in the early 1990's. India faced persistent and growing fiscal deficits which were financed by public borrowing and borrowing from the Reserve Bank of India. This led to high debt and high inflation (around 13%) in the economy. India also showed a large deficit on its current account (around $10 billion) and its balance of payments and high foreign debt had reached crisis levels. Foreign exchange reserves were down to two weeks of imports and remittances from non-resident Indians, which had helped India's balance of payment previously, had dried up. There were serious problems in the public sector with poor management, overmanning and lack of new technology. Public enterprises had shown a low rate of return on the capital invested and had

to be heavily subsidised by the government. *(Joshi V and Little I.M.D., 1996 , chapters 1, 2 and 7; Rothermund R, 1993, chapters 9 and 10; Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8)*

The economic crisis and the failure of India's economic strategy since independence had arisen due to a combination of factors which included:

- faulty planning with over emphasis on heavy industry and insufficient focus on consumer goods and agriculture
- under-used and badly managed public services
- diversion of vital government funds into defence
- lack of family planning leading to huge population growth
- unpredictable supplies of foreign aid
- natural catastrophes such as drought, floods, earthquakes and cyclones

(Joshi V and Little I.M.D., 1996, chapters 1, 2 and 7; Rothermund R, 1993, chapters 9 and 10; Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8)

The Finance Minister, Dr Man Mohan Singh, a free enterprise economist, took major initiatives to stabilise the economy. At the same time he also started a long term program of liberalisation and de-regulation of the economy, moving away from control to competition. Tight fiscal control to reduce fiscal deficits was introduced and the rupee was devalued by 19%, supported by standby credit from the IMF. Import controls were reduced on raw materials and components and exporters were allowed to maintain foreign currency accounts for the first time. Industrial licensing was abolished, restrictions on large companies to expand capacity were reduced and areas reserved for the public sector were reduced. In addition, controls over foreign trade were reduced, tariffs and subsidies were reduced, foreign direct investment was encouraged and the tax system was reformed. *(Joshi V and Little I.M.D., 1996, chapters 1, 2 and 7; Rothermund R, 1993, chapters 9 and 10; Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8)*

The economy of India stabilised and its performance improved in the period from 1991 to 1996. The GDP growth rate increased from less than 1% to 5% and inflation halved. The current account deficit reduced, balance of payments improved and both foreign exchange reserves and exports increased significantly

up to 1995/96. Manufacturing output and agricultural output too increased and inflation was reduced to around 5% by 1996. *(Joshi V and Little I.M.D., 1996, chapters 1,2 and 7; Rothermund R, 1993, chapters 9 and 10; Wolpert S., 1997, chapters 23 to 26; Kulke H and Rothermund D, 1995, chapter 8)*

The next elections were held in 1996 and once again, a hung parliament ensued. The largest party in the 1996 election was the Bhartiya Jananta Party, a Hindu fundamentalist party led by Atul Bihari Vajpayee and Lal Advani. However the BJP were unable to form a government for more than twelve days due to lack of support from the Congress and other secular parties. *(India today review 1996/1997, 15th January 1997)*

There followed a period of coalition government which were put together with compromises between all members of the coalition. The first coalition was a left wing coalition, called the United Front, led by Dev Gowde, the chief minister of Karnataka, one of India's states, the only acceptable leader to all the parties in the coalition. The foreign affairs minister was I Gujral and the Minster of finance was P Chidambaram. Chidambaram was a Harvard trained economist who progressed liberalisation of the economy and it was clear that, even with a coalition of left wing parties, there was no going back to the days of central planning. Indeed, all parties in India, accepted the need for economic liberalisation but economic performance did not improve in the mid 1990's, after encouraging results from 1991 to 1996. *(Aiyar V.S. and Rekhi S., 24th August 1998; Chakravorty S. and Aiyar V.S., 1st June 1998; Rekhi S., 8th June 1998)*

The Gowde administration lasted until March 1997. Another coalition government was then formed in March 1997 with another left wing coalition formed under the premiership of I Gujral, the former foreign minister. This coalition continued for longer than expected but finally collapsed in December 1998 and Gujral continued as a caretaker Government until the elections could be held. Elections were held in February 1998, and the BJP gained the most seats, but again did not gain an outright majority. This time the BJP were able to form a coalition Government. In this period, they stated that they would continue with economic reforms but little real change in policies were seen, due to weak coalition government. They also initiated nuclear tests in 1998, which gave

India full nuclear capacity, a populist move. The BJP coalition government lost a vote of confidence in December 1998 and in March 1999 elections were set for October 1999. The BJP remained as a caretaker Government until the October 1999 elections and in these elections, the BJB gained a larger majority.*(Dasgupta S. and Ansari J.M., 8th December 1997; Bhaumik S.N., 17th May 1999; Editorial, India Today, 9th November 1999)*

During the period of coalition, major policy initiatives could not be progressed due to lack of stability and disagreement between coalition members. The election of a party with a clear majority may break the deadlock that has affected policy making, including economic reform, in India since the mid 1990's. Economic reforms in the early 1990's had tackled some of the revenue raising problems in India but had not addressed expenditure reform. For example, subsidies need to be reduced, the public sector, which makes large losses, needs reform, infra-structure is poor and needs to be improved and the expenditure on the large and inefficient administration needs to be cut. Financial institutions, for example the nationalised banks, needed to be reformed to improve their independence. All these areas still need to be tackled and liberalisation needs to be speeded up. This will only be possible with strong political will and this has been lacking in India, which has been governed by weak coalition and minority governments since the mid-1990's. *(Joshi V and Little I.M.D., 1996, chapters 1, 2 and 7)*

Conclusions

The key cultural values of India have been identified to be:

- a strongly hierarchical society and high power distance, seen in all social systems in India
- respect for authority and tradition
- religious and philosophical beliefs which provide a social and moral code for daily life and help to lead to low uncertainly avoidance
- family based social system in which the needs of the family are more important than the individual
- a kinship favour system
- high masculinity

- highly collective society
- hierarchical caste system

Hierarchy and high power distance appear be the dominant cultural value in Indian and certainly seem to take precedence over low uncertainty avoidance. Social hierarchy is seen in all the social systems in society, for example within the extended, joint family and the caste system, and indeed, is justified by the religious and philosophical texts such as the Rig Veda and the Upanishads.

The cultural and social values identified influence all social systems and institutions in India, including the economic and political institutions and systems. Both cultural values and the economic and political institutions also influence the accounting system and the process of accounting change. An outline of the key political and economic institutions at independence and the development of the political and economic system from independence to 1998 has been given. The key concerns in the different time periods are identified as follows:

- **from independence to the 1960's**

  Economic and social development, equity between the different stakeholders in society and the fairer distribution of wealth, eradication of poverty and creating one nation out of all the different regions and different communities existing in India.

- **in the 1970's**

  Job creation, increasing economic efficiency and growth, modernisation and professional management in the corporate sector, control of corporate sector, foreign exchange control, stimulating exports, controlling imports and the concentration of economic wealth.

- **in the 1980's**

  Liberalisation of the economy, simplification of regulations, protection of the investing public, rapid economic growth, foreign exchange, energy crises and the modernisation of the corporate sector.

- **in the 1990's**

  stabilisation and liberalisation of the economy in order to deal with the economic crisis

The colonial history of India is also seen to be an important influence on India, since many institutions and ideals, such as the legal system, the political system and the education system, were inherited from the British at independence. In addition, the involvement of Government in all areas of social and economic life is seen. This is considered appropriate, as is the use of statutory regulation, promulgated by parliament, in areas such as social reform, to protect the corporate sector, to provide help for sick companies and to control foreign exchange.

The next chapter outlines the accounting framework and identifies the changes that will be analysed in chapters 6 to 13. Both this chapter and chapter 4 will provide information which is used extensively in the analysis of the changes in chapters 6 to 13.

Chapter 5

The Accounting System in India: An Overview

Introduction

The cultural and social values and the economic and political system in India have been discussed in chapter 4. These are expected to influence the accounting values seen in the accounting system in India and the process of accounting change in India. The influence of cultural values on accounting values and the accounting system and the development of the accounting system since independence are discussed below.

Accounting values in India

Cultural values, both universal and country specific, affect the accounting values seen in any country. Gray (1988) proposed that universal cultural values would affect accounting values as follows:

- high individualism, high uncertainty avoidance and low power distance would indicate a preference for professional authority within the accounting system
- low individualism, high uncertainty avoidance and high power distance would indicate a preference for flexibility within the accounting system
- low individualism, high uncertainty avoidance and high masculinity would indicate a preference for conservatism within the accounting system
- low individualism, high uncertainty avoidance, high power distance and high masculinity would indicate a preference for secrecy within the accounting system

As discussed in chapter 4, the cultural values of India have been identified by Hofstede *(1980)* to be low individualism, low uncertainty avoidance, high power distance and high masculinity. Country specific cultural values in India include a

male dominated, hierarchical, family based society. Government control is seen in all aspects of social life and is expected to be important in accounting too. In addition, many systems in India were introduced into India by the British, for example the legal system, the civil service and the political system. These are expected to be important in regulating the accounting system, which is also expected to be affected by the British influence. *(Chapter 4)*

The cultural values of India, outlined above, combine in such a way that does not clearly indicate whether there will be professionalism or statutory control, uniformity or flexibility, secrecy or transparency or optimism or conservatism within the Indian accounting system. It is expected that elements of both uniformity and flexibility, elements of both professionalism and statutory control, elements of both secrecy and transparency and elements of both optimism and conservatism will be seen, as follows:

- authority for the accounting system will be a combination of statutory and professional authority with both strong statutory control and strong professional control being present in the accounting system.
- there will be a mixture of uniformity and flexibility in the application of accounting practices.
- there will be mixed measurement practices, some showing optimism and some showing conservatism.
- there will be mixed disclosure practices, with a mixture of secrecy and transparency. It is expected that some areas will be very well disclosed but other areas will have virtually no disclosures.

Of the above, it is expected that the more dominant accounting values will be uniformity, secrecy, conservatism and statutory control, due to the dominant cultural values of high power distance and low individualism in India, with strong hierarchy seen in all the social systems in India, including the family unit and the caste system.

Indications of the actual accounting values used in the accounting system in India are identified, as outlined in chapter 3, using:

- the survey of company accounts for the year ending in 1996.

- the survey of company accounts from the 1940's and 1950's.
- a review of the literature.
- interviews in India in October and November 1998.

(Chapter 3)

The actual accounting values indicated by the above data are discussed below:

The authority of the accounting system and application of accounting regulations

From the survey of company accounts for the year ending in 1996, it is seen that legal regulation, through the Companies Act, is the most important means of regulating accounting in India. This fits in with the general culture and social context of the country, in which many areas of social, economic and business life in India are regulated by law and the government. The use and importance of legal accounting regulation can be traced back to the legal system inherited from Britain. India inherited a strong British based legal system at the time of independence. This form of regulation was continued after independence but made stronger and more detailed than in Britain. India used a regulatory method that fitted in with its culture and adapted it for its own social and economic needs, in a way that was consistent with its culture. *(Chapter 4; Kapadia, 1972, chapter 2)*

The survey of company accounts for the year ending in 1996 shows that all companies follow the regulations in the Companies Act 1956 in a very uniform way. For example, formats for financial statements and accounting measurement and disclosure requirements for investments, stock, fixed assets, contingent liabilities, audit reports and directors reports, which are all required by the Companies Act, are followed by all the companies in the survey. This is also seen in the survey of company accounts from the 1940' s and 1950's to the 1990's. All companies follow the requirements of the Companies Act in full and thus uniformity is seen in the accounting system of India. *(survey of company accounts for the year ending in 1996; survey of company accounts from the 1940's and 1950's; chapter 4)*

There is some flexibility in the legal regulation of accounting. If companies do not wish to follow the Companies Act, they can apply to the Company Law Board (CLB), the government body that enforces the Companies Act, to vary the provisions of the Companies Act. Companies may wish to do this if they consider that some disclosures are not appropriate to them or they wish to use different categories to those prescribed in the Companies Act. Out of the 89 companies surveyed for the year ending in 1996, 3 companies had applied to the CLB to deviate from the provisions of the Companies Act. This allows the Government to retain control over accounting provisions but also provides some flexibility in the application of the regulations. However, this flexibility is not used very often and most companies follow accounting regulations uniformly. This is confirmed in the interviews, with all interviewees stating that the Companies Act is the most important form of corporate regulation in India, that all large companies follow the Companies Act uniformly and that there is little actual flexibility in whether companies follow the Act or not. *(survey of company accounts for the year ending in 1996; interviews with all parties involved in accounting in October and November 1998)*

The survey of company accounts for the year ending in 1996 and the survey of company accounts from the 1940's and 1950's, also indicate that there is a combination of statutory and professional authority in the accounting system in India. As well as accounting regulations included in the Companies Act, the ICAI promulgate accounting standards in key areas. The accounting standards promulgated by the ICAI are detailed in appendix 11a. Of the 15 standards promulgated by the ICAI, all standards except for standards on depreciation, inventories and the statement of source and application of funds, are mandatory. The surveys show that all mandatory standards are complied with by the companies surveyed. *(survey of company accounts for the year ending in 1996; survey of company accounts from the 1940's and 1950's)*

However, the accounting standards on depreciation, inventories and statement of source and application of funds statement remain recommendatory and, as expected, are not followed by all companies. Indeed, these standards were not made mandatory because the corporate sector indicated that they would not follow the standards. This

was confirmed in the interviews conducted in October and November 1998. Interviewees stated that the ICAI was an important institution in relation to accounting regulation, since it promulgated accounting standards and there was general agreement that these standards were less important than the Companies Act. This confirmed that both statutory control and professional control were important in the accounting system of India. *(survey of company accounts for the year ending in 1996; survey of company accounts from the 1940's and 1950's; interviews with all parties involved in accounting in October and November 1998)*

However, a few interviewees presented the point of view that only the Companies Act was important in terms of accounting regulation. Accounting standards promulgated by the ICAI were not legally binding and hence the ICAI could not enforce even mandatory standards effectively. The interviewees stated that if companies chose not to follow mandatory accounting standards, then there was little that the ICAI could do to force them to follow the standards. In fact, the ICAI only requires companies to make disclosures when mandatory accounting standards are not followed. If such disclosures are not made, then statutory auditors are required to qualify the accounts in their audit reports. However, companies are not generally concerned about such qualifications as they are deemed to be very minor qualifications. However, even the interviewees who held this point of view, confirmed that, in practice, most large companies did follow the mandatory accounting standards and the lack of compliance with accounting standards was mainly with the rest of the corporate sector. *(survey of company accounts for the year ending in 1996; interviews with all parties involved in accounting in October and November 1998)*

The survey of accounts from the 1940's and 1950's also confirmed these findings. Before 1977 there were no accounting standards which affected the accounting practices of companies. Since 1977, 15 accounting standards were promulgated, but these standards did not really have an impact on accounting practice until they were made mandatory. Until this happened, few companies actually followed the accounting standards. However, when standards were made mandatory, most companies did change their practices, if necessary, to comply with the accounting standards. *(survey of company accounts from the 1940's and 1950's)*

This very much indicates that the ICAI is an important institution within the accounting system and that, in addition to statutory authority for the accounting system, there is some professional authority for the accounting system. However, in practice, statutory authority is stronger and the Companies Act a more important form of accounting regulation than regulation by accounting standards promulgated by the ICAI. In addition, it is seen that uniformity is prevalent in the application of accounting regulations in India.

Optimism/conservatism in the accounting system

From the survey of company accounts for the year ending in 1996 and the survey of company accounts from the 1940's and 1950's, measurement practices do show some indication of optimism. For example some companies revalue their fixed assets. However, there is little overall support for the presence of optimism in the accounting system of India. There is strong legal control of accounting and until recently, loan finance has been an important source of finance for companies. This indicates that accounting practices are more likely to be conservative. This is supported by the interviews undertaken in October and November 1998. Most of the interviewees stated that, in their opinion, accounting practices in India were conservative. This may be due to the dominant cultural values of high power distance and strong hierarchy seen in India. *(survey of company accounts for the year ending in 1996; survey of company accounts from the 1940's and 1950's; interviews with all parties involved in accounting in October and November 1998)*

Transparency/secrecy in the accounting system

The survey of company accounts for the year ending 1996 and the survey of accounts from the 1940's and 1950's also give some indication of the level of secrecy in the accounting system in India. In general, it is seen that companies do not make many disclosures unless required to do so by the Companies Act and/or accounting standards promulgated by the ICAI. Thus for areas such as accounting polices, inventory, investments, fixed assets, depreciation, directors report disclosures, prior

period items, research and development, higher paid employees, review of business activities, licenses, extraordinary items and contingent liabilities, little is disclosed until regulations require disclosure. When regulations are promulgated, only what is regulated is disclosed. This supports the prediction of secrecy in the accounts. *(survey of company accounts for the year ending in 1996; survey of company accounts from the 1940's and 1950's)*

However, in addition to the above most companies in India make significant voluntary disclosures in certain areas. These are obtained from the survey of company accounts ending in 1996 and in the survey of accounts from the 1940's and 1950's and are summarised in appendix 9. *(survey of company accounts for the year ending in 1996; survey of company accounts from the 1940's and 1950's)*

From the appendix, it can be seen that the disclosures made by more than 70% of the companies relate to employee relations, collaborations in business, financial highlights (current year and historical summaries), and identification of the board of directors. More than 50% of the companies also disclose profitability ratios.

Other disclosures made by 20-50% of companies include general community work, environment, value added or distribution of revenue statements, strategy and future prospects statements, gearing and liquidity ratios and the training policy of the company.

These disclosures fall into two broad categories

- financial highlights, strategy and business collaborations
- social, environmental and employee related disclosures

Both fit in with the cultural, political and economic context of India, as discussed in chapter 4. The first category are all related to economic success and the future development plans of companies and the second relates to the social aims of India, which have been to achieve economic success along with social fairness. This is also seen in some of the regulations promulgated in India, which are very specific to

India. For example, some of the areas which are not commonly seen in other countries and which are regulated in India include the following:

- extensive disclosure of higher paid employees and whether they are related to senior management
- technology absorption and conservation of energy
- business reviews

The disclosures outlined above indicate some transparency in the accounts of companies in India. However, apart from these areas, only information required to be disclosed by regulation is seen. On the whole, therefore, secrecy is more prevalent in the accounting system of India, since key disclosures are only made when regulations require such disclosures. Secrecy is also indicated by the fact that the disclosure of accounting policies has only been required since the early 1990's. Before this, accounting polices were not disclosed leading to a lack of transparency in Indian company accounts. The standard setting process is also secretive with no detail given as to who is giving comments on exposure drafts and what these comments are. *(survey of company accounts for the year ending in 1996; survey of company accounts from the 1940's and 1950's)*

The interviews conducted in October and November 1998, also indicate the above. Most interviewees stated that they considered that there was secrecy in the accounting practices of companies in India. Some also qualified this with the comment that this probably applied to companies in any country. Most companies would not, wherever based, want to disclose more than they were required to do so. There was some support from the interviews for transparency in the Indian accounting system, but this was very much a minority view. Most interviewees also commented that, in their opinion, the employee and social disclosures did not really increase the transparency of company accounts. These disclosures did not give much real additional information to users since they were very general and were not audited. Companies could therefore make these disclosure with little cost, mainly for public relations purposes. This, in their opinion, did not increase transparency in the accounting system. *(interviews in India with all parties involved in accounting in October and November 1998)*

Thus, on the whole, the surveys and interviews show support for secrecy in the Indian accounting system with perhaps a little transparency is some areas, rather than a mixture of secrecy and transparency. This may be explained by the dominance of hierarchy and respect for tradition and authority over the other cultural values in India.

From the above, it can be seen that the prediction of both statutory and professional accounting control in the Indian accounting system is supported by the surveys and the interviews. Statutory control is seen with important accounting regulations being included in the Companies Act, which is followed uniformly by all large companies in India. Professional accounting regulation is also seen with the promulgation of accounting standards by the ICAI.

There is less support for the other predictions. The survey and interviews do not support the predictions that both uniformity and flexibility, both optimism and conservatism and both secrecy and transparency will be seen in the accounting system of India. Instead, the interviews and the surveys indicate uniform application of regulations, conservative accounting practices and secrecy, with perhaps a limited amount of flexibility, optimism and transparency in the Indian accounting system. This may be due to the cultural values of India combining in such a way in which they are not reinforced and hence leading to indications of actual accounting values which are different from the predictions. Indeed the findings could be explained by the dominance of hierarchy and high power distance in Indian society. With high power distance dominating over the other cultural values of low uncertainty avoidance, high masculinity and weak individualism, accounting practices are likely to be more uniform, conservative and secretive than flexible, optimistic and transparent.

The above results are exploratory, since the results are obtained from surveys and interviews with relatively small numbers. This may lead to findings which appear to contradict predictions when the predictions may, in fact, be correct. However, this latter problem is not expected to be occur, even though there are a relatively small numbers of interviews and surveys of past company accounts, since the results

appear to be supported by all the sources of data obtained and not just by one source of data.

It can be seen that the above findings do indicate that culture and social context are expected to be important in influencing the accounting system in India. The main institutions within the accounting system which regulate financial accounting and auditing are identified to be the DCA and the ICAI. The main forms of regulation are identified to be the Companies Act 1956 administered by the DCA and accounting standards promulgated by the ICAI, itself regulated, to some extent, by the DCA. It is also expected that accounting will be influenced by political processes with Government involvement in accounting and accounting being the outcome of the interactions of different parties interested in accounting. The main parties are expected to be the DCA and the ICAI within the accounting system.

In addition to professional accounting regulation by the ICAI and the importance of the Companies Act in accounting regulation, the involvement of three other institutions and bodies in accounting regulation are indicated in the surveys and the interviews. These are the ICWAI, the tax authorities and the stock exchanges. The survey indicates that cost accounting and cost auditing is seen in the accounting system with many companies disclosing that cost audits have been performed and the fees paid to cost auditors. The ICWAI and cost accounting is also identified as an important part of the accounting system in the interviews. Taxation too is indicated in the survey of accounts from the 1940's and 1950's as an influence on accounting. Some companies stated the Income Tax 1961 influenced their depreciation policies and made disclosures on the tax audit from 1986. In addition, in informal discussions with parties involved in the accounting system and in the formal interviews, the increasing role of the tax authorities in accounting standard setting in the 1990's is identified. Finally, the stock exchanges are identified, in the survey of company accounts for the year ending in 1996, in informal discussions and formal interviews, as requiring the publication of cashflow statements in 1996 and hence also influencing the accounting system. *(survey of company accounts for the year ending in 1996; survey of company accounts from the 1940's and 1950's; interviews with all parties involved in accounting in October and November 1998)*

The development of the accounting system in India and identification of the changes to the system chosen for further analysis are discussed below.

The development of the accounting system in India

Soon after independence, the Indian Government set up the key components of the accounting system in India. The Companies Act was promulgated in 1956 and the accounting profession was set up from 1949 to 1959. In this period, the two main professional accounting bodies, the Institute of Chartered Accountants of India (ICAI) and the Institute of Cost and Works Accountants of India (ICWAI), were set up. As the accounting system developed, the Companies Act underwent many changes and the professional accounting institutes became more active in promulgating accounting regulations. In addition, a third professional institute was set up in 1980, the Institute of Company Secretaries of India (ICSI), to help in the administration and enforcement of the Companies Act 1956. In the 1980's and 1990's, the tax authorities and the stock exchanges too became involved in accounting regulation. The Government, through the DCA, played a key role in all the developments in the accounting system and played an important role in all regulations relating to accounting, including:

- The Companies Act 1956, administered by the DCA.
- Accounting standards promulgated by the ICAI.
- Cost accounting and cost auditing requirements promulgated using Companies (Amendment) Acts and undertaken by members of the ICWAI.
- Tax audit requirements and tax accounting standards promulgated by the taxation authorities.
- SEBI guidelines and stock exchange listing regulations for quoted companies, in particular regulations requiring the cashflow statement.

The main changes to the accounting system and the main regulations in the accounting regulations are discussed below.

The Companies Act 1956

The Companies Act can be traced back to before independence. The Companies Act was first introduced in 1850 to regulate the corporate sector by the British Government in India. The Companies Act contained accounting regulations, was generally based on British legislation, and was introduced to facilitate British investments in India. Changes to the Companies Act were made in 1857, 1882, 1913 and 1936 and at independence, the Companies Act 1913, as amended by the Companies (Amendment) Act 1913 was extant. *(Kapadia G.P., 1972, chapter 2; Chakravorty D.K., 1994, chapter 3)*

After independence, the Government chose to retain the use of the Companies Act to regulate the corporate sector and accounting and chose to change the Companies Act extant at independence, which had been promulgated by the British. The process for revising the Companies Act started in 1947 and ended with the promulgation of the Companies Act 1956. Between 1947 and 1949, the Government appointed two legal advisors to advise them on what changes were needed to the Companies Act. Based on the findings of these advisors, the Ministry of Commerce drafted a memorandum on the possible content of a new Companies Act. This memorandum received many criticisms and these criticisms led the Government to appoint a committee of 12 members, the Company Law Committee, under the chairmanship of a judge, Mr H.C. Bhabha. The Company Law committee was set up to consider the provisions of the Companies Act extant at independence and to report on the amendments needed to the Act, in light of the conditions existing in India at independence. The Company Law Committee reported in 1952 and on the basis of the recommendations of this committee, the first Companies Act after independence, the Companies Act 1956 was promulgated. *(Kapadia G.P., 1972, chapter 2; Chakravorty D.K., 1994, chapter 3; Company Law Committee, 1952, pages 1 to 20)*

After the Companies Act 1956 was promulgated the Government set up a separate department, the Department of Company Law Affairs (DCLA) in 1956 to administer the Companies Act 1956. This evolved into the Department of Company Affairs (DCA) which administers and regulates all accounting matters including the Companies Act 1956 and the accounting profession in India. The DCA is one of the

key regulatory bodies within the accounting system in India. *(Kapadia G.P., 1972, chapter 2; Chakravorty D.K., 1994, chapter 3; Chander S., 1992, chapter 1)*

Soon after the Companies Act became law, some difficulties were encountered in the operation of the Act, due to the complexity of the Act and vagueness of some of its provisions. These criticisms led to the Government of India setting up another committee, in 1957, the Company Law Amendment Committee, under another judge, Mr A.V.V. Shastri, which led to amendments being made to the Companies Act 1956 in 1960. Periodic amendments have been made to the Companies Act since 1960 with changes to financial accounting requirements introduced in 1963, 1974 and 1988. Attempts to change the Companies Act also took place in 1993 and 1997. *(Kapadia G.P., 1972, chapter 2; Chakravorty D.K., 1994, chapter 3; Chander S., 1992, chapter 1)*

The main accounting provisions of the Companies Act 1956 and the changes to the Companies Act are outlined below:

The main requirements of Companies Act 1956

Some of the main requirements of the Companies Act 1956 include the following:

- every company must keep proper books of account with respect to:

  a all sums of money received and expended by the company
  b all sales and purchases of goods by the company
  c the assets and liabilities of the company
  d the cost accounting records, where required by the Government

  (Section 209 of the Companies Act 1956)

- the Board of Directors of a company must lay a balance sheet as at the end of the financial year and a profit and loss account for the financial year, at every AGM. *(Section 210 of the Companies Ac 1956)*
- the balance sheet must give a "true and fair view" of the state of affairs of the company and has to be prepared in accordance with formats set out in Part I of Schedule VI to the Act. *(Section 211 and Schedule VI of the Companies Act 1956)*
- the profit and loss account shall give a true and fair view of the affairs of the company for the financial year. The specific items to be disclosed in the profit and loss account are specified in part II of Schedule VI to the Companies Act 1956. No formats for the profit and loss account are specified. *(Section 211 and Schedule VI of the Companies Act 1956)*

- the government has the power to exempt any class of companies from compliance with any of the requirements in Schedule VI. It can also modify these requirements if this is considered appropriate. *(Section 211 of the Companies Act 1956)*
- the directors must prepare a report on the company's state of affairs, proposed dividend, amount to be transferred to reserves and material changes and commitments affecting the financial position of the company that have occurred between the end of the financial year and the date of the report. *(Section 217 of the Companies Act 1956)*
- the balance sheet and profit and loss account shall be audited by a chartered accountant, or a firm of chartered accountants, holding a certificate of practice issued by the ICAI. The auditing requirements are discussed in more detail below. *(Sections 224 to 233 of the Companies Act 1956)*
- a copy of the balance sheet, profit and loss account, auditors report and directors report must be sent to every shareholder at least 21 days before the AGM and filed with the filed with the Registrar of Companies within 30 days from the date of the AGM. *(Sections 219 and 220 of the Companies Act 1956)*
- the preparation of consolidated financial statements for holding companies is not required. Instead, the Companies Act requires that the following documents relating to each subsidiary be attached to the balance sheet of the parent:

  - balance sheet, directors' report and auditors report of the subsidiary.
  - statement of the parent's interest in the subsidiary, indicating the total profit of the subsidiary
  - changes in the parents' interest in the subsidiary.
  - material changes in the subsidiary's financial position between the end of the financial year of the parent and the subsidiary, if the two financial years do not coincide.

  (Section 212 of the Companies Act 1956)

Since 1956, there have been many changes to the Companies Act 1956. Periodically, amendment bills have been passed, changing the provisions of the Companies Act. The main amendment bills which have revised the accounting provisions of the Act are summarised as follows:

The Companies (Amendment) Bill 1963

The Company Law Board (CLB) was set up by the Central Government in accordance with the Companies (Amendment) Bill 1963. *(Section 10E of the Companies Act 1956).* The CLB was set up to help enforce the provisions of the Companies Act

including reviewing company accounts to check compliance with the accounting provisions of the Companies Act. Since its constitution, the CLB has had powers to enforce the provisions of the Companies Act and has had the authority to punish any company not complying with the Companies Act. *(Chakravorty D.K., 1994, chapters 2 and 3; interviews with senior Government officials on 5th and 17th November 1998)*

When the CLB was set up, it was initially placed under the control of the DCA. Since 1988 the CLB has been a statutory body with powers and duties specified by legislation. The role of the CLB has been to review whether the corporate sector is complying with the Companies Act, including the accounting regulations contained in the Act, but not to consider any policy issues, which are left to the DCA. The DCA has always been in charge of accounting policy and in charge of administering the Companies Act, including dealing with any changes to the Companies Act. Thus the DCA is the more important institution in the process of accounting change, within the accounting system. *(Chakravorty D.K., 1994, chapters 2 and 3; interviews with senior Government officials on 5th and 17th November 1998)*

The Companies (Amendment) Bill 1974

The Companies (Amendment) Bill 1974 was the first major change to the Companies Act since its promulgation in 1956. Amendment bills had been passed before 1974 with some changes to the Act, for example the introduction of the CLB in the Companies Amendment Bill 1963, but there was no major change to the Act until 1974. The Companies (Amendment) Bill 1974 introduced major changes to the whole Companies Act, including major changes to the accounting provisions of the Act. *(Chakravorty D.K., 1994, chapters 2 and 3; interviews with senior Government officials on 5th and 17th November 1998)*

The main accounting changes in the Companies (Amendment) Bill 1974 included:

- requiring companies to identify all higher paid employees in the company. *(Clause 22 of the Companies (Amendment) Bill 1974, amending Section 217 of the Companies Act 1956)*
- requiring cost audits to be performed by members of the ICWAI. *(Clause 25 of the Companies (Amendment) Bill 1974, amending Section 233 of the Companies Act 1956)*

- introducing the requirement for companies to employ company secretaries. *(Clause 30 of the Companies (Amendment) Bill 1974, introducing new Section into the Companies Act 1956)*

- introducing a ceiling on the number of audits that any one statutory auditor could perform. *(Clause 20 of the Companies (Amendment) Bill 1974, amending Section 224 of the Companies Act 1956)*

- discussing the possibility of introducing auditor rotation. *(Clause 20 of the Companies (Amendment) Bill 1974)*

The Sachar report on accounting and financial reporting

The next attempt to change the Companies Act came with the setting up of the Sachar Committee to review the Companies and the Monopolies and Restrictive Trade Practices (MRTP) Acts. The Government set up an expert committee, under the chairmanship of a judge, Mr Sachar, to review the Companies and the MRTP Acts. This committee, known as the Sachar committee, reported to the Government in 1978. Some of the recommendations of the committee included introducing the following:

- disclosures of prosecutions of company directors
- disclosures of any unpaid dividends
- disclosures of investments in corporate bodies
- disclosures of unprovided liabilities
- disclosures of the company's social activities
- disclosures of key accounting ratios
- disclosures of any shares held by directors
- disclosures of related party transactions

(Report of the Expert Committee on the Companies and MRTP Act, 1978; Chakravorty D.K., 1994, chapters 2 and 3; Chander S., 1992, chapter1)

The recommendations of the Sachar committee report were not implemented. Instead, the recommendations to the Sachar committee report were reviewed in the process to promulgate the Companies (Amendment) Bill 1988, which was the next major change to the Companies Act 1956. *(Report of the Expert Committee on the Companies and MRTP Act, 1978; Chakravorty D.K., 1994, chapters 2 and 3; Chander S., 1992, chapter)*

The Companies (Amendment) Bill 1988

The next major change to the Companies Act 1956 took place in 1988. This led to changes to the accounting system which included:

- the delegation of many powers of central government and the courts to the Company Law Board (CLB). *(Clauses 4,36, 37, 41 and 43 of the Companies (Amendment) Bill 1988, amending Sections 10, 235, 248 and 250 of the Companies Act 1956)*

- companies were allowed to send summary financial statements to their members. *(Clause 31 of the Companies (Amendment) Bill 1988, amending Section 219 of the Companies Act 1956)*

- depreciation was to be calculated in accordance with a new schedule introduced by the Bill rather than calculated in accordance with the Income Tax Act. *(Clauses 1 and 26 of the Companies (Amendment) Bill 1988, amending Sections 66 and 205 of the Companies Act 1956)*

- companies were required to keep all books of account on an accruals basis and according to the double entry system of accounting. *(Clause 29 of the Companies (Amendment) Bill 1988, amending Section 209 of the Companies Act 1956)*

- companies were required to disclose conservation of energy, technology absorption, research and development and foreign exchange earnings and outgo in the directors' report in a prescribed manner. *(Clause 30 of the Companies (Amendment) Bill 1988, amending Section 217 of the Companies Act 1956)*

- provisions on the number of audits that any one auditor could undertake were tightened and extended to cost auditors. *(Clause 35 of the Companies (Amendment) Bill 1988, amending Section 233 of the Companies Act 1956)*

- company secretaries were required to be members of the ICSI and were given the duty of signing annual returns. "Secretaries in whole time practice" were introduced. *(Clause 2 of the Companies (Amendment) Bill 1988, amending Section 233 of the Companies Act 1956)*

The Companies Bill 1993

The Companies Bill 1993 was drafted to change the Companies Act 1956 after liberalisation of the Indian economy was started in 1990. However, the bill did not introduce any significant changes to the Act. It deleted the managing agency provisions from the Companies Act, which were redundant, but did not make any other major changes to the Act. The Bill was never promulgated. *(Companies Bill 1993; interviews in India with all parties involved in accounting in October and November 1998; Bannerjee B., 1997)*

The Companies Bill 1997

The Companies Bill 1997 was drafted by an expert committee set up in 1996 to review the Companies Act 1956 and suggest changes to the Act, in light of the liberalisation of the economy in India. This bill contained many new provisions and suggested some significant changes to the accounting regulations contained in the Companies Act 1956. These included:

- the setting up of a National Advisory Committee on Accounting Standards to advise the Government on accounting policies and to issue accounting standards. *(Section 415 of Companies Bill 1997, August 1997)*
- the appointment of a chief accounts officer for large companies who was expected to be a member of the ICAI. *(Clause 5.26 of the Report of the Working Group, Section 172 of the Companies Bill 1997, May 1997)*
- provisions allowing companies to prepare group accounts on a voluntary basis. *(Clause 5.25 of the Report of the Working Group, Section 168 of the Companies Bill 1997, May 1997)*
- the requirement for large companies to have audit committees. *(Clause 4.18 of the Report of the Working Group, Section 230 of the Companies Bill 1997, May 1997)*

The Companies Bill 1997 had not been promulgated by the end of 1998, the time period for the thesis. However, some of the key provisions in the Bill were promulgated by the DCA through the Companies (Amendment) Ordinance 1998. *(Companies Bill 1997; interviews in India with all parties involved in accounting in October and November 1998; Companies (Amendment) Ordinance 1998)*

Of the above changes to the Companies Act 1956, the promulgation of the Act itself and changes to the Act in 1974 and 1988 and the attempt to change the Act in 1997 are chosen for further analysis in chapters 6 to 9, as these are identified to be the most important changes to the accounting system. The Companies Bill 1963 and the Companies Bill 1993 were not chosen as they did not include major changes to the accounting system. The Sachar committee review of the Companies Act was an important review of the law, but was not implemented and the findings of this committee were taken into account in the Companies (Amendment) Bill 1988. Hence, the Companies (Amendment) Bill 1988 was chosen for analysis rather than the Sachar committee review of the Companies Act 1956. No other major changes to the Companies Act 1956 were identified in the survey of company accounts from the 1940's and 1950's, in informal discussions with parties involved in the accounting system and in the interviews with parties involved in the accounting system in October and November 1998. *(survey of company accounts for the year ending in 1996; survey of company accounts from the 1940's and 1950's; interviews in India with all parties involved in accounting in October and November 1998; Chakravorty D.K., 1994, chapters 2 and 3; Chander S., 1992, chapter 1; Kapadia G.P., 1972, chapters 1 to 6)*

The accounting profession and auditing in India

The Institute of Chartered Accountants of India (ICAI)

The ICAI was set up in 1949, soon after independence, to regulate accounting and auditing in India. The ICAI was set up under statutory legislation, the Chartered Accountants Act 1949, with the co-operation of the Indian Accountancy Board. This was a board set up by the Government in 1932 to advise on all accounting matters. The ICAI was headed by a Council which contained elected chartered accountants and nominated government and business representatives. The role of the ICAI was to regulate entry into the accounting profession and to deal with examinations, education, professional ethics and discipline. As such, the ICAI has been one of the main regulatory institutions within the accounting system. *(interviews in India with all*

parties involved in accounting in October and November 1998; Kapadia G.P., 1972, chapters 2 and 3)

After it was set up in 1949, the ICAI set up its operational structure in line with the requirement of the Chartered Accountants Act 1949. The ICAI set up three committees under its Council, the executive committee, the examinations committee and the disciplinary committee. The ICAI also set up a secretariat to deal with administrative issues. The first priorities of the ICAI were to deal with the examination and articleship requirements for training chartered accountants, to increase the numbers of chartered accountants in India, deal with disciplinary matters and raise the profile of the Institute. *(interviews in India with all parties involved in accounting in October and November 1998; Kapadia G.P., 1972, chapters 4,5 and 6)*

In addition, the ICAI gave guidance to their members on accounting issues by setting up committees such as the research committee and the company law committee. These committees were set up to help interpret the Companies Act and other government regulations and to undertake research into accounting. The ICAI also issued guidelines and recommendations on accounting policies and disclosures. However, these were not mandatory and they did little to reduce the variety of accounting practices in India. To address this problem, the ICAI decided to set up a committee, the Accounting Standards Board (ASB), under the Council of the ICAI, to promulgate accounting standards, in 1977. The ASB was constituted in April 1977 by the Council of the ICAI to harmonise the diverse accounting policies and practices used in India and also to review international developments in the field of accounting. *(interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998)*

The ASB prepares accounting standards using a due process system, which involves preparers and users of accounts. The standards are then reviewed and promulgated by the Council of the ICAI. The accounting standards promulgated by the ICAI are initially recommendatory. The ICAI then promotes the use of the accounting standards and educates chartered accountants and the corporate sector about the utility of accounting standards and the need for compliance with the accounting standards. Once the need for the accounting standards is accepted by the corporate

sector, the accounting standards are made mandatory. Since 1977, the Council of the ICAI and the ASB have promulgated 15 accounting standards, and all but three of the accounting standards have been made mandatory. Details of the accounting standards promulgated by the ICAI are given in appendix 11a. *(interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998; Chakravorty D.K., 1994, chapter 2; Chander S., 1992, chapter 1)*

From the survey of company accounts for the year ending in 1996 and the survey of company accounts from the 1940's and 1950's, it is seen that the mandatory standards are followed by most companies, but as expected, the recommendatory standards are not always followed. The mandatory standards are followed in a very uniform way with companies making very similar disclosures, in compliance with the accounting standards. This fits in very much with the view of mixed authority for accounting system with both strong statutory control and strong professional control. It also demonstrates the uniformity of the accounting system. *(survey of company accounts for the year ending in 1996; survey of company accounts from the 1940's and 1950's)*

Auditing and the ICAI

The ICAI has been closely linked with auditing in India since only chartered accountants are allowed to undertake statutory audits in India, the membership of the ICAI comprises of auditors and members of the auditing firms usually hold senior positions in the ICAI.

The auditing requirements in India are wider than in the UK and, since independence, have been increased quite considerably. The audit requirements include the following for financial accounting:

- the statutory audit which is similar to the statutory audit in Britain. However, the statutory audit report is extended in India and specifically states the work carried out by the auditor. The Companies Act 1956 includes the provisions relating to the statutory audit, covering the appointment, rights and duties of auditors. These were promulgated in 1956 and are similar to provisions found in British Companies Acts. *(Sections 224 to 233 of the Companies Act 1956)*

- the Government has the power under the Companies Act 1956 to order special audits of companies where it considers this appropriate and necessary. *(Section 233 of the Companies Act 1956)*

- the MAOCARO audit. In addition to the statutory audit, the Manufacturing and Other Companies (Auditors Report) Order (MAOCARO), promulgated under section 227 of the Companies Act requires the statutory auditor to carry out further checks for companies in specified industries which include the following:
  - whether the company is maintaining proper records on fixed assets and stock, whether fixed assets have been revalued and whether fixed assets and stock have been physically verified
  - whether loans have been taken from, or given to, related parties, whether such loans are prejudicial to the interests of the company and whether such loans are being repaid
  - whether there are adequate internal control procedures in the company
  - where companies are required to keep cost accounting records, whether these are being kept
  - whether the companies are paying provident fund contributions and employees state insurance
  - whether amounts payable in respect of income tax and other taxes have been paid
  - whether personal expenses have been charged in company accounts
  - whether the company is a sick company

(Statement on the Manufacturing and Other Companies Auditors Report Order 1988 promulgated under section 227(4a) of the Companies Act 1956)

The MAOCARO statement was promulgated in 1975 by the Government and extended in 1988, in conjunction with the ICAI.

This audit framework is much wider than seen in most other developing countries and, indeed, wider than in western countries which have historically influenced India for example Britain and the USA.

To provide further guidance on the auditing duties of chartered accountants, the ICAI issued statements or notes of auditing practices until 1982, but these were not mandatory. In 1982, following the setting up of the ASB, the ICAI established the Auditing Practices Committee (APC) to promulgate standards on auditing practice. The APC was constituted to give guidance on auditors' duties and responsibilities, and since 1982 has promulgated the following statements of standard auditing practices (SAP):

-	SAP 1	Basic principles governing and audit
-	SAP 2	Objective and Scope of the audit of financial statements
-	SAP 3	Documentation
-	SAP 4	Fraud and Error
-	SAP 5	Audit evidence
-	SAP 6	Study and Evaluation of the Accounting System and Related Internal Controls in Connection with an Audit
-	SAP 7	Relying upon the work of an internal auditor
-	SAP 8	Audit Planning
-	SAP 9	Using the Work of an Expert
-	SAP 10	Using the Work of another auditor

(ICAI, Compendium of Statements and Standards on auditing, 1995)

Members of the ICAI who undertake audits are required to follow these SAP's, in the conduct of their audits.

The setting up of the ICAI and the setting up of the standard setting process in India are chosen for further analysis. The setting up of the APC is also an important event in the history of the accounting profession. However, this is not chosen for analysis since the processes for promulgating accounting standards and auditing standards are similar and thus similar insights are expected to be obtained from the analysis of both changes. Furthermore, accounting standards affect most parties interested in accounting, whereas auditing standards affect only auditors and the corporate sector. Thus, it is expected that the analysis of accounting standard setting will give more information on the influence of culture and politics on accounting and hence is chosen for analysis, rather than the setting up of the APC and the promulgation of auditing standards.

The Institute of Cost and Works Accountants of India (ICWAI)

The ICWAI was first set up as a private company in 1944 by senior Indian cost accountants to train Indian cost accountants to work in the defence industry during the second world war. After independence, the Government recognised the need for

cost accounting as a tool to help promote economic efficiency and growth, in both the private and the public sector. This led to the setting up of the ICWAI as a statutory body, in 1959, in a similar way to the ICAI. The role of the ICWAI was to train cost accountants to work in companies and public enterprises and to perform cost audits to ensure that companies who were required to keep cost accounting records were doing so. The Government introduced the requirement for particular industries to keep cost accounting records in the Companies (Amendment) Bill 1960, immediately after the ICWAI was set up as a statutory body and introduced the requirement for these industries to have a cost audit in the Companies (Amendment) Bill 1965. *(Kapadia G.P., 1972, chapter 6; interview with senior member of the accounting profession on 17th November 1998; interview with senior Indian academic on 7th November 1998)*

At independence, there were very few qualified cost accountants in India, and thus, the priority of the ICWAI was to train cost accountants to undertake cost accounting work and to undertake cost audits. In addition, the Companies Act did not define what was meant by cost accounting records. This was left to the DCA who delegated this task to the ICWAI. The ICWAI therefore prepared industry specific guidelines as to what was meant by cost accounting records, which were then published and made mandatory by the Government. *(interview with senior member of the accounting profession on 17th November 1998; interview with senior Indian academic on 7th November 1998; Kapadia G.P., 1972, chapters 2 and 3)*

The setting up of the ICWAI and the promulgation of the cost accounting and the cost auditing requirements were important events in the development of the accounting system in India. It is also expected that these changes will provide interesting insights into the interactions between the Government, the ICAI and the ICWAI and hence are chosen for further analysis.

The Institute of Company Secretaries of India (ICSI)

The third professional institute in India which has some involvement in accounting regulation is the Institute of Company Secretaries of India (ICSI). As for the ICWAI, the ICSI was set up in the 1960's as a private company. The ICSI was set up by former members of the DCA to train company secretaries to help companies

implement the requirements of the Companies Act. There were close links between the ICSI and the DCA within the Government. The DCA was supportive of the ICSI as they perceived that this institute would help with the enforcement of the Companies Act. Thus the Government included the requirement for all companies over a certain size, to employ members of the ICSI as company secretaries in the Companies (Amendment) Bill 1974, the Companies (Amendment) Bill 1988 and the Companies Bill 1997. *(interview with senior representative of the accounting profession on 20th November 1998)*

Once the ICSI had been in existence for some years, the Government chose to set up the ICSI as a statutory body using legislation, in a similar way to the setting up of the ICAI and the ICSI as statutory bodies. The ICSI which had been set up as a company was dissolved and a statutory ICSI was set up under the Company Secretaries Act, 1980. The ICSI was set up in a similar way to the ICAI and the ICWAI, with a Council to run the institute, which contained both elected representatives and Government nominees. *(interview with senior representative of the accounting profession on 20th November 1998)*

The ICSI was not chosen for analysis for the following reasons:

- the process for setting up the statutory ICSI was identical to the processes for setting up the ICAI and the ICWAI. Hence this change would not provide any further insights into the process of accounting change.
- the ICSI was not directly involved in accounting matters. The ICSI was set up to help enforce all the provisions of the Companies Act 1956 and its role in accounting was less important than the role of the ICAI and the ICWAI.

From the above, it can be seen that there are four main regulatory institutions within the accounting system in India, the DCA and the three professional accounting bodies, the ICAI, the ICWAI and the ICSI. Of these the DCA, the ICAI and the ICWAI are more directly involved in accounting. The DCA is the government department which regulates the whole of the accounting system, including the professional accounting institutes, the ICAI regulates financial reporting and auditing and the ICWAI regulates cost accounting. Thus the setting up of the ICAI and the ICWAI are chosen for further analysis. In addition, the standard setting program of

the ICAI is chosen for further analysis as these are the most important professional accounting regulations in the accounting system in India. The role of the DCA is expected to be important in all changes to the accounting system and is analysed in all the changes chosen for further analysis.

Accounting regulation and taxation

In India, as in the UK, there is no direct link between accounting and tax. Accounting profits are the starting point for the calculation of tax, and these are then adjusted to obtain the tax payable by a company. The corporate tax laws are part of the Income Tax Act 1961 and this Act has, indirectly, influenced the accounting practices of companies. For example, before 1988, the depreciation rates that companies had to follow for tax purposes were included in the Income tax Act and many large companies used these rates for accounting purposes too. In 1988, the depreciation rates were delinked from the Income Tax Act and revised rates that companies had to follow were included in the Companies Act itself. These rates were lower than in the Income tax Act and were argued to better reflect the use of fixed assets by the corporate sector. *(survey of company accounts for the year ending in 1996; survey of company accounts from the 1940's and 1950's; Kotrappa G., 1996, chapter 1)*

Taxation and the taxation authorities in India have also influenced the accounting system in India more directly. The tax authorities have initiated two main changes to the accounting system. The first relates to the requirement for certain companies to have tax audits since 1986, which has increased the audit requirements of companies. The second relates to the tax authorities in India promulgating accounting standards themselves in the 1990's. Both these changes are chosen for analysis as they provide information on the interactions of different parties on the process of accounting change and are regulations which are not common in other countries. Thus, it is expected that these two changes will provide interesting insights into culture and politics and accounting change. *(survey of company accounts for the year ending in 1996; survey of company accounts from the 1940's and 1950's; Gupta K, 1992, chapter 15 ; interviews in India with all parties involved in accounting in October and November 1998)*

Accounting regulation by the Stock Exchange

The stock exchanges and their regulatory body too are involved in accounting to some extent. As outlined in chapter 4, the stock exchanges in India are organised on a regional basis. Of the regional stock exchanges in India, the Bombay Stock Exchange is the oldest, largest and most important stock exchange in India. In addition to the regional stock exchange, a national stock exchange was set up in the 1990's using a paperless system, based along the lines of the London Stock Exchange. *(Chapter 4)*

The stock exchanges themselves have been regulated, since 1988, by the Securities and Exchange Board of India, (SEBI). SEBI was initially set up under the Ministry of Finance and in 1992 was set up as a statutory body under the Securities and Exchange Board of India Act, 1992.

SEBI has powers to control and regulate stock exchanges including:

- granting recognition to stock exchanges.
- having the power to direct inquiries into the operations of stock exchanges.
- specifying what should be included in the listing requirements of the stock exchange.

Stock exchanges regulate quoted companies in two ways. When companies list for the first time, or float additional shares on the stock exchange, they are required to follow the listing requirements. In addition, all quoted companies have to follow annual listing requirements. Both types of listing requirement are regulated by SEBI.

Listing requirements for companies listing for the first time include:

- have capital exceeding a specified minimum
- the articles of association of companies must include specified items
- companies must prepare a prospectus and application for listing including:
    - five years worth of financial statements and other documents
    - certified copies of key agreements of the company

- statement containing particulars of all material contracts entered into by the company
- short history of the company
- details of what the funding raised would be used for, including projected cashflows and areas of risk in the use of the funds

(Stock exchange, Listing agreement; Nabhi's, 1998 chapter 12)

Annual listing requirements for quoted companies include the following:

- provision of annual financial statements which are expected to follow accounting standards promulgated by the ICAI
- reconciliation of actual cashflows to projections made at the time of raising funds
- publication and certification of cashflow statements
- submission of quarterly returns

(Stock exchange ,annual listing agreement; Nabhi's, 1997, chapter 12)

SEBI and the stock exchanges have not, generally, become involved in promulgating accounting regulations. This has been left to the ICAI. Instead SEBI and the stock exchanges require quoted companies to follow accounting standards promulgated by the ICAI and to disclose price sensitive information in a particular format and within a specified time period. However, in 1995, SEBI and the stock exchanges promulgated regulations, which required quoted companies to publish cashflow statements in their annual reports. From the survey, it is seen that the cashflow statement is published by all companies and certified by the statutory auditors as required by the regulations, by all companies. *(survey of company accounts for the year ending in 1996; survey of company accounts from the 1940's and 1950's; interviews in India with all parties involved in accounting in October and November 1998)*

When SEBI and the stock exchanges promulgated the requirement for companies to publish the cashflow statement, the ICAI was concerned that SEBI and the stock exchanges might become more active in promulgating accounting regulations. The ICAI, therefore, held meetings with the stock exchanges and SEBI, in which it was clarified that SEBI and the stock exchanges did not intend to become involved in accounting matters and that these would be left in the hands of the ICAI. *(interviews with senior representative of the stock exchanges and SEBI on 2nd, 5th and 6th November 1998;*

interviews with senior representative of the accounting profession on 3rd. 4th, 9th and 18th November 1998)

Indeed, SEBI and the stock exchanges clarified that promulgating the regulation for companies to publish cashflow statements was done as an extension of the cashflow information requirement that companies had to provide, as per the listing agreement, and not as an active attempt to become involved in accounting matters. For this reason, the stock exchange is not chosen for further analysis. However, the influence of the stock exchanges and SEBI on accounting change are included in the analysis of the changes chosen for analysis, where appropriate. For example, the stock exchanges and SEBI are consulted in the due process system used by the ICAI to promulgate its standards.

Conclusions

It is expected that culture and politics will influence the process of accounting change in any country. In India, the cultural values predict that the accounting system in India will show a mixture of statutory and professional control, a mixture of uniformity and flexibility, a mixture of optimism and conservatism and a mixture of transparency and secrecy. The surveys and interviews support the prediction that accounting will demonstrate both statutory and professional control. However, the surveys and interviews indicate that, secrecy and conservatism are seen in the Indian accounting system with only a limited amount of transparency and optimism. In addition, the accounting practices and regulations in India are applied in a very uniform manner, with little actual flexibility seen in the accounting system. This maybe due to the dominance of hierarchy and high power distance in Indian culture and society, reinforced by low individualism. In addition, social, political and economic institutions have been influenced by Britain and it is expected that the accounting system, too, will be influenced by British ideals and practices.

The accounting system is outlined and the main changes to the accounting system since independence, are identified to be:

- the promulgation of the Companies Act 1956, amendments to the Companies Act in 1974 and 1988 and the attempt to change the Companies Act in 1997.
- the setting up of the ICAI
- standard setting by the ICAI
- the setting up of the ICWAI and the promulgation of the cost accounting and cost auditing regulations
- the promulgation of the tax audit regulations and the promulgation of tax accounting standards by the tax authorities

These have been identified using the literature on India, the survey of company accounts from the 1940's and 1950's, in discussions with parties involved in accounting in India and in formal interviews during visits to India, as outlined in chapter 3, and are thus chosen for further analysis.

The reasons for choosing these changes are also discussed and it is expected that these changes will provide the greatest insights into the influence of culture and politics on the process of accounting change. The changes are analysed in chapters 6 to 13 as follows:

Chapter 6	The promulgation of the Companies Act 1956
Chapter 7	The promulgation of the Companies (Amendment) Bill 1974
Chapter 8	The promulgation of the Companies (Amendment) Bill 1988
Chapter 9	The promulgation of the Companies Bill 1997
Chapter 10	The setting up of the ICAI
Chapter 11	Standard setting by the ICAI
Chapter 12	The setting up of the ICWAI, cost accounts and cost audits
Chapter 13	The influence of taxation on accounting and financial reporting

Chapter 6

The Promulgation of the Companies Act 1956

Introduction

When the British colonised India, they introduced many British systems into India including the regulation of joint stock companies by statutory regulation in the form of a Companies Act. The first Indian Companies Act was promulgated in 1850 and was based on British legislation. The Indian Companies Act was then amended periodically and the amendments were also based on developments in British Companies Acts. At the time of independence, the Indian Companies Act 1913, as amended by the Indian Companies Bill 1936, based on the British Companies Acts 1908 and 1929, was extant. *(Das Gupta N., 1977, pages 14 to 17)*

The Indian Companies Acts, although based on British Companies Acts, did contain some provisions which related to the Indian context. For example, formats for balance sheets were specified and there were provisions relating to the managing agency system used to run many companies in India. But on the whole Indian Companies Acts were promulgated to facilitate British Investments in India and were similar to corresponding British legislation. *(Report of the Company Law Committee, 1952, pages 16 to 20)*

At independence in 1947, the Indian Government chose to retain the use of a Companies Act to regulate joint stock companies but decided to amend the Indian Companies Act extant at independence to deal with the Indian social, economic and political context. This led to the promulgation of the Companies Act 1956, which is discussed below.

The main provisions of the Companies Act 1956

The main changes that were made in the Companies Act 1956 related to:

- the promotion and formation of companies.
- the control of companies by shareholders and the position of minority shareholders.
- the powers, duties and functions of directors and managing agents.
- the appointment, and conditions of service, of directors and managing agents.
- company accounts and audit.
- the investigation and inspection of companies by Government.
- the liquidation of companies.
- the administration and enforcement of the Companies Act .

(Report of the Company Law Committee, 1952, pages 19 to 20; Parliamentary proceedings, Chartered Accountant, vol ii, September 1954, pages 124 to 128; In Parliament, Chartered Accountant vol ii, April 1954, pages 532 to 535

The process for the promulgation of the Companies Act 1956 and the main provisions of the Act are outlined below:

The Process For Promulgating and Revising the Companies Act 1956

The revision of the Indian Companies Act 1913 took ten years. The process of changing the Act started in 1946 and ended ten years later with the promulgation of the Companies Act 1956. Very soon after its promulgation, the Companies Act 1956 had to be revised due to problems in its operation. The promulgation of the Companies Act 1956 and its subsequent revision can be broken down into four main stages as follows:

- Government initiatives at independence reviewing how the Indian Companies Act 1913 should be amended (1946 to 1950).
- The Company Law Committee review of the Companies Act 1913 suggesting changes to the 1913 Act (1950 to 1952).
- The Parliamentary Process leading to the promulgation of the Companies Act 1956 (1952 to 1956).

- The Company Law Amendment Committee review of the operation of the Companies Act 1956 leading to amendments to the Companies Act 1956 (1957 to 1960).

These are discussed below.

Government initiatives at independence, (1946 to 1950)

The review of the Companies Act 1913 was started in 1946 by the appointment of Shri Tricumdas Dwarkadas, a legal expert, by the Government of India to review the Indian Companies Act 1913. His remit was to make suggestions as to how the Act should be amended in light of significant developments in trade and industry since 1936 and in light of changes to the English Companies Act. Shri Tricumdas Dwarkadas reported back to the Government in 1947 but was unable to complete his review, which was continued by another legal expert, Shri V.K. Thirvenkatachari who reported back to the Government in 1948 on possible areas of change to the Indian Companies Act 1913.

The Ministry of Commerce reviewed the findings of the legal experts and prepared a Memorandum summarising possible changes to the Companies Act 1913. This Memorandum was published by the Ministry of Commerce as the "Memorandum on the Amendment of the Indian Companies Act" in 1949 *(Government of India Publications, 1949)*.

The Memorandum was circulated to all parties interested in the revision of the Companies Act including state governments, trade and industrial organisations, bar councils, accountants, the high courts and the general public in 1949 with the intention of gaining feedback from the interested parties on the way forward.

However, most of the recipients of the Memorandum considered it to be a summary of key proposals which the Government intended to implement rather than a discussion document and criticised the lack of consultation by the Government. The Government had to clarify the status of the Memorandum as a discussion document and invited comments on the Memorandum from anyone interested in the revision of the Companies Act 1913. *(Report of the Company Law Committee, 1952, pages 3 to 5)*

Many representations were received by the Government in response to their request for feedback and the analysis of these representations became the work of the Company Law Committee (known as the Bhabha committee after its chairman) which was set up on 28th October 1950 by the Government of India. *(Report of the Company Law Committee, 1952, pages 3 to 5)*

The Company Law Committee, (1950 to 1952)

The Company Law Committee was set up on 28th October 1950 by the Government of India and was asked to consider and report on amendments necessary to the Indian Companies Act with particular reference to:

- the formation of companies and the day to day conduct of their business.
- the powers of management vis-a-vis shareholders, the relations between the management and shareholders and how managerial efficiency may be reconciled with the rights of investors.
- how the interests of creditors, labour and other partners in the corporate sector maybe safeguarded.
- the prevention of abuses in company practices.
- the attainment of social and economic development.
- any other matters incidental to the administration of the Indian Companies Act in its bearing on the development of Indian trade and industry.

(Report of the Company Law Committee, 1952, page 3 and page 12)

The Company Law Committee consisted of twelve members and included members of parliament, legal experts, members of the business community, accountants and civil servants. The committee's first task was to review the written representations received in response to the "Memorandum on the Amendment of the Indian Companies Act" which had been issued by the Government in 1949. Based on these representations the Company Law Committee invited witnesses to give evidence to the Committee on any aspect of company law. The parties giving

evidence to the Company Law Committee are summarised in appendix 10.

The Company Law Committee appointed a sub-committee to :

- compare the Indian Companies Act 1913 to the British Companies Act 1948, provision by provision.
- review company law developments in other countries such as the Cohen Committee in the United Kingdom, the Millin Commission in South Africa and company law in the United States of America.
- make suggestions for possible changes to the provisions of the Indian Companies Act 1913 and to prepare preliminary drafts of these provisions.

(Report of the Company Law Committee, 1952, pages 3 to 15)

The sub-committee consisted of three members, one of whom was a senior accountant and a member of the newly formed Institute of Chartered Accountants of India (ICAI). The sub-committee prepared a report recommending changes to the Indian Companies Act 1913, including preliminary drafts of key provisions. This report was debated and approved by the main Company Law Committee with very little change. The Company Law Committee reported back to the Government at the end of February 1952 and their main proposals were to:

- amend key definitions in the Act for example definitions of "debentures" and "associates". *(Clause 27 of the Report of the Company Law Committee, 1952, amending Section 1 of the Indian Companies Act 1913)*
- tighten the provisions on the formation of companies for example tightening the provisions relating to the memorandum and articles of companies. *(Clause 34 of the Report of the Company Law Committee, 1952, amending Section 17 of the Indian Companies Act 1913)*
- revise the provisions on the issue and transfer of shares for example restricting the ability of companies to issue shares with disproportionate voting rights. *(Clause 47 of the Report of the Company Law Committee, 1952, introducing new Section 93 to the Indian Companies Act 1913)*
- revise the provisions relating to prospectuses for example increasing the information that needed to be provided by companies in their prospectuses. *(Clause 55 of the Report of the Company Law Committee, 1952, amending Section 93 of the Indian Companies Act 1913)*
- specify directors duties including restricting the remuneration they could earn from companies. *(Clauses 80, 82 and 101 of the Report of the Company Law Committee, 1952, amending Section 83 of the Indian Companies Act 1913)*
- amend the provisions relating to managing agents for example tightening

the appointment, conditions of service and remuneration of managing agents but not recommending that the managing agency system be abolished. *(Clauses 113-146 of the Report of the Company Law Committee, 1952, amending Sections 82 and 87 of the Indian Companies Act 1913)*

- increase the powers of Government to inspect and investigate companies. *(Clauses 190 to 205 of the Report of the Company Law Committee, 1952, introducing new Section to the Indian Companies Act 1913)*

- increase the provisions relating to foreign companies for example requiring foreign companies with a presence in India to prepare accounts in line with the new Companies Act. *(Clauses 223 and 224 of the Report of the Company Law Committee, 1952, amending Section 277 of the Indian Companies Act 1913)*

- recommend the setting up of an independent body to administer and enforce the Companies Act. *(Clauses 252 to 263 of the Report of the Company Law Committee, 1952, introducing new Section to the Indian Companies Act 1913)*

- increase the accounting and audit requirements for companies, for example:

  - specifying detailed formats for the balance sheet. *(Clauses 153 to 161of the Report of the Company Law Committee, 1952, amending Section 132 of the Indian Companies Act 1913)*

  - specifying the items to be included in the profit and loss account. *(Clauses 153 to 161 of the Report of the Company Law Committee, 1952, amending Section 132 of the Indian Companies Act 1913)*

  - introducing the requirement for accounts to show a true and fair view. *(Clause 149 of the Report of the Company Law Committee, 1952, introducing new Section to the Indian Companies Act 1913)*

  - defining what was meant by "books of account". *(Clause 154 of the Report of the Company Law Committee, 1952, amending Section 130 of the Indian Companies Act 1913)*

  - requiring holding companies to give details of their interests in subsidiaries but not requiring the preparation of consolidated accounts. *(Clauses 162 and 169 of the Report of the Company Law Committee, 1952, introducing new section of the Indian Companies Act 1913)*

  - providing a list of persons not eligible to be auditors of a company. *(Clauses 144 and 145 of the Report of the Company Law Committee, 1952, amending Section 171 of the Indian Companies Act 1913)*

  - making recommendations on the appointment and removal of auditors. *(Clauses 144 and 145 of the Report of the Company Law Committee, 1952, amending Section 171 of the Indian Companies Act 1913)*

  - specifying the powers and duties of auditors. *(Clauses 144 and 145 of the Report of the Company Law Committee, 1952, amending Section 171 of the Indian Companies Act 1913)*

The Parliamentary Process, (1952 to 1956)

The Ministry of Finance reviewed the report of the Company Law Committee and, on the basis of this report, drafted the Companies Bill 1953. Most of the provisions of the Companies Bill 1953 were in line with the recommendations of the Company Law Committee but there were two main differences to the Company Law Committee recommendations:

1 The Company Law Committee had recommended the setting up of an independent body to administer and enforce the Companies Act. This was not included in the Companies Bill 1953. Instead the Central Government retained the responsibility for the administration and enforcement of the Companies Act. They also proposed the setting up of an advisory body to advise the Central Government on all the provisions of the Act. *(Clauses 409 to 411 of the Companies Bill 1953)*

2 The Company Law Committee had recommended that the managing agency system be retained but amended. The Companies Bill 1953 included provisions which significantly curtailed the managing agency system, for example identified key industries which would stop using the managing agency system within three years and introduced many restrictions on the managing agency system such that in practice, it would be difficult to carry on using such a system. *(Clauses 323 to 377 of the Companies Bill 1953)*

Apart from the above, most of the other provisions of the Companies Bill 1953 were very much in line with the recommendations of the Company Law Committee.

The Companies Bill 1953 was introduced in Parliament on 2nd September 1953 by the Finance Minister and was referred to a joint committee for review by both the Lok Sabha and the Rajya Sabha in April and May 1954. The joint committee consisted of thirty-three members of the Lok Sabha and sixteen members of the Rajya Sabha. These members represented all the major political parties. In addition, two draftsmen from the Department of Economic Affairs in the Ministry of Finance were placed on special duty with the joint committee.

The committee held sixty-one sittings in total, during which it obtained representations from all the main parties interested in the Companies Bill, examined the drafting of Bill and reviewed the schedules of the Bill. The parties

giving evidence to the committee are summarised in appendix 11.

The joint committee submitted its report in May 1955, recommending amendments to the Bill. The recommendations did not alter the Companies Bill very significantly and included:

- widening the definitions of key terms for example associates, debentures and relatives. *(Clause 10 of the Report of the Joint Committee, 1953, amending Section 2 of the Companies Bill 1953)*

- increasing the powers of the central government for example giving them powers to decide on whether trade was through a branch or not and giving the central government the power to alter company names. *(Clauses 12 and 13 of the Report of the Joint Committee, 1953, amending Sections 8 and 11 of the Companies Bill 1953)*

- increasing the amount of loans available for purchase of shares by employees. *(Clause 35 of the Report of the Joint Committee, 1953, amending Section 76 of the Companies Bill 1953)*

- restricting the ability of companies to issue shares at a discount. *(Clause 36 of the Report of the Joint Committee Report, 1953, amending Section 76 of the Companies Bill 1953)*

- increasing slightly the time limit for the submission of annual returns to the registrar. *(Clause 65 of the Report of the Joint Committee, 1953, amending Section 59 of the Companies Bill 1953)*

- restricting overall managerial remuneration to a specified percentage of net profits. *(Clause 75 of the Report of the Joint Committee, 1953, amending Section 193 of the Companies Bill 1953)*

- withdrawing the ability of companies to appoint non ICAI members as auditors. *(Clause 75 of the Report of the Joint Committee, 1953, amending Section 225 of Companies Bill 1953)*

- requiring auditors to give reasons for audit qualifications. *(Clause 86 of the Report of the Joint Committee Report, 1953, amending Section 226 of Companies Bill 1953)*

- recommending that a statutory body be set up to administer and enforce the Companies Act. This was not accepted. *(Clause 147 of the Report of the Joint Committee, 1953)*

- recommending that a new Government department be set up to administer the Companies Act. This was not accepted. *(Clause 164 of the Report of the Joint Committee, 1953)*

The Bill was then debated in the Lok Sabha and the Rajya Sabha. There was some support for the Companies Bill. Many politicians felt that its provisions would help curb malpractices in company management, provide transparency in

corporate affairs and that Government should have strong powers of control over the corporate sector. However, the Bill was not without some criticisms. Some parties argued that the Bill introduced too many restrictions and rigidities into the corporate sector, increased the bureaucracy for companies and gave too much power to the Government. Other parties argued that the Bill did not go far enough in regulating the corporate sector, that labour had not been fairly dealt with and that the provisions relating to the managing agency system did not go far enough. The arguments for and against the Bill are given in appendix 12. *(Report of the Joint Committee, 1953, pages xxviii to lxii; Indian Parliamentary debate on the Companies Bill 1953, 5th to 10th September 1955)*

No major changes were made to the Companies Bill 1953 at the parliamentary debate stage and the Companies Act 1956 received assent and became the Companies Act 1956 on 1 April 1956. *(Report of the Company Law Amendment Committee, 1957, pages 2 to 3)*

The Company Law Amendment Committee and subsequent amendments to the Companies Act 1956 (1957 to 1960)

Once the Companies Act 1956 had been promulgated, it soon became apparent that there were some practical difficulties in the operation of the Act. The criticisms of the Act made by businessmen, company management, shareholders, accountants, auditors, lawyers and judges, included the following:

- the Companies Act was too long and too complex.
- there was a lack of clarity in many of the provisions of the Act.
- there was government involvement in corporate affairs, even in minor matters.
- there was increased bureaucracy in the Act for example a large increase in the number of forms and returns required to be furnished by companies.
- many loopholes have been left in the Act such that the effectiveness of the Act was reduced.

(Report of the Joint Committee, 1953, pages xxviii to lxii; Indian Parliamentary debate on the Companies Bill 1953, 5th to 10th September 1955; (Report of the Company Law Amendment Committee, 1957, pages 4 to 6)

To rectify some of these problems, the Government of India undertook two measures

1 they set up a separate department, the Department of Company Law Administration, under the Ministry of Finance, to deal with the administration and enforcement of the Companies Act 1956. The Department of Company Law Administration was later to become the Department of Company Affairs.

2 they constituted an ad hoc committee, the Company Law Amendment Committee on 15th May 1957 to consider what amendments to the Companies Act were necessary:

- to overcome the practical difficulties in the working of the Act.
- to remove drafting defects and obscurities in the Act.
- to ensure better fulfilment of the purposes underlying the Act.
- to simplify the Act.

(Report of the Company Law Amendment Committee, 1957, pages 4 to 8)

The Company Law Amendment Committee consisted of four members (a solicitor, a chartered accountant, a company director and the Joint Secretary of the newly formed Department of Company Law Administration) under the chairmanship of a retired judge, AV Shastri. The Company Law Amendment Committee was asked to review the Companies Act 1956 and make suggestions to plug loopholes, clarify ambiguities, correct mistakes and remove inconsistencies, to make the working of the Act more effective but not to rewrite the Act completely. *(Report of the Company Law Amendment Committee, 1957, pages 1 to 8)*

During their review of the Companies Act 1956, the Company Law Amendment Committee invited parties interested in the Companies Act to give both written and oral evidence to the Committee. The parties giving evidence to the Company Law Amendment Committee are summarised in appendix 13.

The Company Law Amendment Committee reported back to the Government in 1957 and their main recommendations included:

- clarifying definitions in the Companies Act for example definitions of "associate", "managing director" and "relative". *(Clauses 10 to 24 of the Report of the Company Law Amendment Committee, 1957, amending Section 2 of the Companies Act 1956)*

- removing the ability of companies to delay filing their annual returns by delaying their AGM. *(Clause 65 of the Report of the Company Law Amendment Committee, 1957, amending Section 159 of the Companies Act 1956)*

- clarifying the managerial remuneration provisions for example specifying that "perquisites" should be included as part of remuneration. *(Clause 83 of the Report of the Company Law Amendment Committee, 1957 amending Sections 198, 309 to 311, 351 to 354, 381 and 387 of the Companies Act 1956)*

- clarifying that it was the directors' duties to maintain proper books of account and introducing a provision which required directors to maintain the books of account for eight years. *(Clause 88 of the Report of the Company Law Amendment Committee, 1957, amending Section 209 of the Companies Act 1956)*

- simplifying the annual returns that companies had to submit to the Registrar. *(Clause 65 of the Report of the Company Law Amendment Committee, 1957, amending Section 159 of the Companies Act 1956)*

- introducing requirements for companies to keep adequate records of share transfers. *(Clause 66 of the Company Law Amendment Committee, 1957, amending Section 161 of the Companies Act 1956)*

- allowing companies to hold AGM's at locations other than at their registered office. *(Clause 69 of the Report of the Company Law Amendment Committee 1957, amending Section 166 of the Companies Act 1956)*

- proposing some minor changes to the formats of the balance sheet. *(Clause 89 of the Report of the Company Law Amendment Committee, 1957, amending schedule vi of the Companies Act 1956)*

- increasing the disclosure requirements of the Directors' Report. *(Clause 92 of the Report of the Company Law Amendment Committee, 1957, amending Section 217 of the Companies Act 1956)*

- recommending that audit firms be allowed to sign the audit report in their business name but then informing the registrar of the auditor who was responsible for the audit. *(Clause 95 of the Report of the Company Law Amendment Committee Report, 1957, amending Section 225 of the Companies Act 1956)*

- increasing the powers of the Registrar for example empowering the Registrar to compel companies to provide books of account and other information within reasonable time periods. *(Clause 99 of the Report of the Company Law Amendment Committee, 1957, amending Sections 235-251 of the Companies Act 1956)*

- relaxing slightly the related party provisions for example so that they did not apply to small contracts. *(Clause 119 of the Report of the Company Law Amendment Committee, 1957, amending Section 297 of the Companies Act 1956)*

On the basis of the report of the Company Law Amendment Committee, the Government drafted an amendment Bill to the Companies Act 1956, the Companies Bill 1960. This Bill went through the normal parliamentary process i.e. reviewed by a joint committee and then debated in both Houses of Parliament as for any other parliamentary Bill. The Bill was very much based on the recommendations of the Company Law Amendment Committee and only minor changes took place at the joint committee and parliamentary debate stages of the promulgation of the Bill. The Bill received asset and became law in 1960. *(Das Gupta N., 1977, pages 14 to 17).*

The promulgation of the Companies Act 1956 can be analysed using the framework proposed in chapter 3. The change can be broken down into three phases, the source phase, the diffusion phase and the reaction phase and these are discussed below.

Analysis of the promulgation of the Companies Act 1956

The Source Phase

As outlined in chapter 4, after independence in 1947, the economic condition of India was very poor and one of the major priorities of the newly elected Indian Government was to improve the economy and eradicate poverty as quickly as possible. This aim of economic growth was combined with socialist principles and the Government set up many institutions to try and achieve these aims. For example, a planning commission was set up to advise on five year plans and industrial policy statements were issued which stated that rapid industrial development would be achieved through a planned economy and the development of a large public sector. *(Chapter 4)*

However, India did not follow the socialist model completely and instituted a mixed economy. Alongside economic planning, there was to be an important role in the economy for joint stock companies, who were to be regulated to try and ensure that they operated in ways, which contributed towards national economic development. *(Chapter 4; Report of the Company Law Committee, 1952, page 3*

and page 19)

To regulate the private sector joint stock companies, the Government of India chose to retain the use of a Companies Act, inherited from their colonial legacy, but decided to completely review and amend the Companies Act extant at independence, the Indian Companies Act 1913, for the following reasons:

- problems and abuses in the actual working of companies particularly during the war. These included problems in the running of companies by directors for their own benefit rather than for the benefit of shareholders and problems in the managing agency system which was used to manage many companies in India.
- recognition that shareholders and creditors had a legitimate interest in companies and should be more involved in the running of companies which could be encouraged by a new Companies Act.
- recognition that the accounting and auditing provisions were inadequate. Higher standards of accounting and auditing were required to give more information on the performance of companies and their managements to users of accounts.
- problems in the administration and enforcement of the Companies Act which had led to many of the provisions of the Act being ignored by companies

(Basu G., Chartered Accountant vol vi, July 1957, pages 8-12; Report of the Company Law Committee, 1952, page 3 and page 19; Report of the Companies Act Amendment Committee, 1957, pages 3 to 4)

Major accounting regulations were incorporated into the Companies Act since accounting was seen as a tool to help economic and social development. As such it was felt that accounting needed to be regulated by statutory means and the Government, rather just than by accountants and the newly formed Institute of Chartered Accountants.

The changes to the accounting system were therefore initiated from outside the accounting system and linked to changes in the Companies Act. There was no one single change stimulating event. Instead, changes were initiated due to the Indian Government's concern to improve the economy and their perception that accounting would help them to do this. They chose to use and adapt the system that they had inherited from the British, choosing to retain the use of a Companies Act which included detailed accounting provisions, thereby choosing

to retain a form of regulation which fitted in with the cultural and social context of India.

The changes made to the Companies Act were also very much linked to the social and economic context of India. Regulation was needed that encouraged companies to behave in ways that would help the national economic objectives of economic growth with social equality and fairness, particularly in the areas of:

- equity between capital, management and labour, all of whom are important in the effective working and profitability of companies
- the creation of employment in the country
- fair distribution of wealth in companies

(Aiyar R.V., Chartered Accountant, vol v, July 1956, pages 241-244)

The need for change was also influenced by events in other countries. The setting up of the Cohen committee which proposed significant changes to the British Companies Act as well as reviews of corporate legislation in other countries such as South Africa and the United States contributed to the need for change to the Companies Act in India. *(Report of the Company Law Committee, 1952, pages 6 to 7)*

The Diffusion phase

The diffusion phase of the promulgation of the Companies Act 1956 took ten years from the first Government initiatives to review the Indian Companies Act 1913 in 1946 and the new Act becoming law in 1956.

There were there were three distinct stages within this ten year diffusion phase period:

- a review of the Companies Act 1913 by legal experts from 1946 to 1950 leading to a discussion memorandum issued by the Ministry of Finance in 1949

- a review of the Companies Act 1913 and proposals for changes on a provision by provision basis by the Company Law Committee from 1950 to 1952
- the drafting of the Companies Bill 1953 and the progression of the Bill through Parliament which included a review of the Bill by a joint committee and parliamentary debates on the Bill

Both intra-system activity and trans-system activity are seen in all the three stages of the diffusion phase. Intra-system activity (activity between the regulatory institutions within the accounting system) is seen between the government and accounting regulation and between the accounting profession (individual accountants, accounting firms and the ICAI) and accounting regulation. Trans-system activity (activity between social systems neighboring the accounting system and the accounting system itself) is seen between the parliamentary, corporate, legal and international systems and accounting regulation. Both intra-system activity and trans-system are discussed below.

Intra-system Activity

Interactions between the Government (Ministry of Commerce and the Department of Economic Affairs under the Ministry of Finance) and accounting regulation in the Companies Act 1956

The Government was involved in, and influenced, the promulgation of the Companies Act 1956 at all stages of its promulgation through both the Ministry of Commerce and the Ministry of Finance. At this stage there was no specialised government department to deal with the administration and enforcement of the Companies Act.

The Ministry of Commerce appointed two legal experts to review the Companies Act 1956 and indicate the lines along which the Companies Act 1913 could be changed in the period 1946 to 1949. Based on the findings of the two legal experts, officials of the Ministry of Commerce drafted the "Memorandum on the Amendment of the Indian Companies Act", which outlined proposals for the

amendment of the Companies Act 1913. The Memorandum was taken to be a statement of intent rather than a discussion document and, as such, was criticised heavily and not implemented. The Memorandum, however, did became the starting point for receiving representations from the different parties interested in the amendment of the Companies Act 1913 as the Government requested feedback on the Memorandum due to the criticisms it had received. *(Report of the Company Law Committee, 1952, pages 3 to 4)*

The Government received many written representations in response to their request for feedback on the Memorandum and the Ministry of Finance was then given the task to deal with the revision of the Companies Act. They did this by setting up an ad hoc committee, the Company Law Committee, to analyse the representations received in response to the Memorandum and to make proposals for amending the Companies Act, 1913, including initial drafts of key sections. *(Report of the Company Law Committee, 1952, pages 3 to 4)*

The Government influenced the Company Law Committee in many ways. The Department of Economic Affairs, under the Ministry of Finance, set the terms of reference for the Company Law Committee and members of the committee included government officials from the Ministry of Finance. In addition, legal draftsmen from the Department of Economic Affairs were seconded to the Company Law Committee to advise them on all aspects of company law. There was regular contact between the Company Law Committee and the Government to discuss issues and to obtain the Government's view on the changes to the Companies Act that were being considered. This contact was a two way process. The Government also consulted the Company Law Committee on other company regulations. For example, it asked the Company Law Committee to review the Companies Bill 1951 which was promulgated while the committee was sitting. *(Report of the Company Law Committee, 1952, pages 3 to 8 and page 19)*

Once the Company Law Committee had reported to Government, officials of the Ministry of Finance drafted the Companies Bill 1953 which was later to become the Companies Act 1956. The Companies Bill 1953 was very much based on the recommendations of the Company Law Committee which had been influenced

by the Government as outlined above. There were only two major differences between the Companies Bill 1953 and the recommendations of the Company Law Committee. These were in the provisions relating to the managing agency system and the setting up of an independent body to administer and enforce the Companies Act.

The Company Law Committee had recommended retaining and amending the managing agency system. However, the Companies Bill 1953 contained provisions which banned the use of the managing agency system in some industries within three years and drastically reduced the scope of the system in other industries such that the future of the managing agency system was in doubt. The managing agency proposals were criticised by some parties as going too far and by others as not going far enough.

However, at independence, there were strong feelings in the Government that the managing agency system had been used to maintain the interests of colonial Britain and had led to too much economic power being vested in the large managing agency firms (both British and Indian). The system needed to be controlled and eventually replaced, although this could not be done immediately due to a shortage of financial expertise in the corporate sector at that time. Hence the Government included stringent controls over the managing agency system in the Companies Bill 1953. The managing agency provisions did not change significantly either at the joint committee stage or the parliamentary debate stage and hence the provisions that were promulgated were in line with the Government's wishes. *(Clauses 116 to 146 of the Report of the Company Law Committee, 1952, amending Sections 82 and 87 of the Indian Companies Act 1913; Clauses 118 to 146 of the Report of the Joint Committee, 1953, amending Sections 323 to377 of the Companies Bill 1953)*

The Company Law Committee had also recommended that an independent body be set up to administer and enforce the Companies Act. The Government took a more cautious step, which was to retain the role of administering and enforcing the Companies Act itself. They also proposed the setting up of an advisory group, called the Company Law Advisory Board, which would have three

members to advise the Government on all issues relating to the Companies Act. This was almost universally criticised by all parties who argued that an independent statutory body was needed for effective enforcement of the Act. However, this was not accepted and the proposals for the central government being responsible for the enforcement and administration of the act and the setting up of an advisory body remained unchanged at both the joint committee stage and the parliamentary debate stage, in line with the Governments wishes. *(Clauses 243 to 263 of the Report of the Company Law Committee, 1952, introducing new sections to the Indian Companies Act 1913; (Clauses 118 to 146 of the Report of the Joint Committee, 1953, amending Sections 323 to 377 of the Companies Bill 1953; Report of the Joint Committee, 1953, pages xxviii to lxii; Indian Parliamentary debate on the Companies Bill 1953, 5th to 10th September 1955)*

From the above it can be seen that the Government via the Department of Economic Affairs in the Ministry of Finance and the Ministry of Commerce was very influential in the promulgation of the Companies Act 1956. They appointed the persons who initially reviewed the Companies Act 1913, appointed the Company Law Committee and were represented on this committee, set the committee's terms of reference, consulted with the committee while it sat, drafted the Companies Bill 1953 and steered the Bill through the parliamentary process. This Bill became the Companies Act 1956 with only minor changes as it progressed through the parliamentary system.

Interactions between chartered accountants / the Institute of Chartered Accountants (ICAI) and accounting regulation in the Companies Act 1956

The accounting profession (individual accountants, accounting firms and the ICAI) were very involved in the diffusion phase of the promulgation of the Companies Act 1956. The ICAI was given parliamentary charter in 1949 and senior members of this Institute were key members of the Company Law Committee which reported to the Government on changing the Indian Companies Act 1913 in 1952.

One member of the ICAI was part of the three member sub-committee of the Company Law Committee which undertook a detailed study of the Companies

Act 1913, compared it to the British Companies Act 1948 and made proposals for changes, including initial drafts of key sections. These drafts were reported to Government and became the basis for the Companies Bill 1953 whose provisions were similar to the recommendations of the Company Law Committee. The accounting provisions included:

- the requirement for accounts to show a true and fair view *(Clause 149 of the Report of the Company Law Committee, 1952, becoming Section 21 of the Companies Act 1956)*
- specified formats for the balance sheet. *(Clauses 153 to 161 of the Report of the Company Law Committee, 1952, becoming schedule vi of the Companies Act 1956)*
- listed the items to be disclosed in the profit and loss account. *(Clause 153 to 161 of the Report of the Company Law Committee, 1952, becoming schedule vi of the Companies Act 1956)*
- specified that the books of account should be kept on the double entry system. *(Clause 154 of the Report of the Company Law Committee, 1952, becoming Section 209 of the Companies Act 1956)*
- extended the provisions relating to the appointment, independence, powers and duties of auditors. *(Clause 171 of the Report of the Company Law Committee, 1952, becoming Section 227 of the Companies Act 1956)*

The accounting profession, including individual accountants, accounting firms and the ICAI, were very influential in changing the Companies Act as they were key members of the Company Law Committee. The ICAI were also invited to give evidence to the parliamentary joint committee, as shown in appendix 11. The accounting profession also lobbied Members of Parliament to present their point of view in the joint committee review and in the parliamentary debates. *(interviews with senior government officials on 10th and 17th November 1998; interviews with senior members of the accounting profession on 3rd November 1998, 4th November, 9th November 1998, 17th November 1998, 18th November 1998 and 20th November 1998)*

In the case of the promulgation of the Companies Act 1956, the accounting and auditing provisions were supported and welcomed by most accountants. Only minor changes were made to the accounting provisions at the joint committee stage and in the parliamentary debates on the Companies Bill 1953 and hence the accounting provisions which were finally promulgated were heavily influenced by the accounting profession, especially the ICAI.

There were very few criticisms of the accounting profession and the accounting requirements proposed by the Company Law Committee at this time. A new Institute had been set up, the ICAI, and this Institute was expected to ensure the highest standards of competence and independence from their members. The accounting and auditing provisions contained in the Companies Act had been drafted by members of the ICAI who were members of the Company Law Committee and were more detailed and more extensive than those included in any previous Companies Act. Thus, it was generally considered that these provisions would ensure that balance sheets and profit and loss accounts would make financial statements transparent and auditors independent.

The accounting provisions, like the other provisions of the Companies Act, were drafted in line with the socio-economic climate of India and India's social and economic objectives. Possible reasons for the promulgation of some of these provisions were to:

- deal with improving information available to shareholders so that they could become more involved in running their companies
- give information to other users such as the Government to monitor the running of companies and to check that the running of companies was not subject to abuses.
- try and ensure that enough information would be available to help monitor the actions of directors
- try and ensure fairness in the rewards earned by labour, capital and management in companies.
- try and ensure that all companies accounted on a more comparable basis
- try and help provide information to the Government for economic planning purposes
- try and facilitate accounting processes since there was a shortage of accountants in India.

(Report of the Company Law Committee, 1952, pages 2 to 9; Report of the Company Law Amendment Committee, 1957, pages 1 to 20; interviews with senior government officials on 10th and 17th November 1998; interviews with senior members of the accounting profession on 3rd November 1998, 4th November, 9th November 1998, 17th November 1998, 18th November 1998 and 20th November 1998)

Indeed, accounting was seen, not just as a technical subject, but as an important tool to encourage rapid economic development. Hence the accounting provisions were incorporated into the Companies Act and not left to the discretion of the accountants, although the view of the accounting profession was taken into account and influenced the drafting of the accounting provisions of the Act.

On the whole the accounting and audit provisions were in line with the expectations of accountants and the ICAI who influenced the provisions in several ways. They were key members of the Company Law Committee and its sub-committee which reviewed the Companies Act 1913 and prepared the draft provisions which were included in the Report of the Company Law Committee. They also made representations to the parliamentary joint committee and lobbied members of parliament to present their point of view

The ICAI was the only professional accounting body which had been given a parliamentary charter at this time. The other professional accounting bodies in India, the Institute of Cost and Works Accountants (ICWAI) and the Institute of Company Secretaries (ICSI) had only recently been set up and were not very active in influencing accounting regulation in the Companies Act 1956.

Trans-system Activity

Interactions between Parliament and accounting regulation in the Companies Act 1956

Accounting in India has always been regarded as an important tool to encourage economic development and hence Government and Parliament have always been actively involved in accounting regulation. Accounting has been used to try and affect corporate behaviour and encourage parties to act in ways deemed optimal by the Government and Parliament, mainly in the areas of economic growth and efficiency but also in the social aims and objectives of the country. This direct influence is considered appropriate since accounting has social and economic implications and consequences and hence affects many different parties. *(Report of the Company Law Committee, 1952, pages 10 and 11)*

The provisions of the Companies Act 1956, including the accounting provisions contained in the Act, were very much linked with the social and economic aims of the country and drafted in line with the political ideology and aims of the country. Accounting change was motivated by social and economic concerns rather than concerns about the technical nature of accounting. Accounting was directly influenced by Parliament, since accounting provisions were included in the Companies Act 1956 which went through the normal parliamentary process of being introduced in Parliament by the Government, reviewed by a committee of Parliament and debated in both Houses of Parliament before receiving assent from the President of India and becoming law. In the case of the Companies Act 1956, an ad hoc committee was set up to review the Companies Act before it went through the parliamentary process and thus the process for promulgating the Companies Act 1956 was longer and more comprehensive than for many pieces of legislation.

Parliament influenced the Companies Bill 1953, later to become the Companies Act 1956, at both the joint committee stage and in the parliamentary debates on the Bill. The joint committee reviewed the Companies Bill 1953 and made some amendments to the Bill. For example, the joint committee:

- amended some of the definitions in the Bill including the definition of "associate" and "relative". *(Clauses 10 and 11 of the Report of the Joint Committee, 1953, amending Sections 2 and 6 of the Companies Bill 1953)*

- increased the powers of the Central Government including giving them powers to alter the names of companies, to decide whether companies traded through a branch and whether companies could be allowed to refrain from sending information to the Registrar as required under the Bill. *(Clauses 12, 16, and 17 of the Report of the Joint Committee, 1953, amending Sections 8, 22, and 24 of the Companies Bill 1953)*

- allowed companies to move their head offices with government approval, where appropriate. *(Clause 63 of the Report of the Joint Committee, 1953, amending Section 145 of the Companies Bill 1953)*

- increased slightly the time limit for submitting annual returns to the Registrar. *(Clause 65 of the Report of the Joint Committee, 1953, amending Section 149 of the Companies Bill 1953)*

- restricted the total remuneration of directors to a specified percentage of net profits of the company. *(Clause 75 of the Report of the Joint Committee, 1953, amending Section 197 of the Companies Bill 1953)*

- specifying who, apart from members of the ICAI, were allowed to undertake audits. *(Clause 85 of the Report of the Joint Committee, 1953, amending Section 225 of the Companies Bill 1953)*

- recommended that both a new department and an independent statutory body be set up to administer the act. This was not accepted. *(Clauses 147 and 164 of the Report of the Joint Committee, 1953)*

The Bill was also debated in both the Lok Sabha and the Rajya Sabha. At the joint committee stage and the parliamentary debate stage arguments were made both supporting the Bill and criticising it. There was support for the Bill as many members of parliament felt that it was a much needed strong Bill which introduced many necessary controls into the private sector, gave the Government strong powers over companies and improved the accounting, audit and inspection requirements. The Bill was also criticised and there were two broad types of criticisms of the Bill. Some members of parliament argued that the Bill was too restrictive and introduced too many Government controls over the corporate sector such that the development of the private sector would be jeopardised. Others argued that the Bill did not go far enough as it still left the corporate sector with too much flexibility and that the managing agency system would not be adequately controlled. The arguments for and against the Bill are summarised in appendix 12. *(Report of the Joint Committee 1953, pages xxviii to lxii; Indian Parliamentary debate on the Companies Bill 1953, 5th to 10th September 1955)*

However, despite these criticisms, there were no major changes to the Companies Bill 1953, including the accounting provisions, at either the joint committee stage or the parliamentary debate stage. Parliament had the opportunity to change the Companies Bill 1953 but chose not to make any major changes. The Bill that was finally promulgated was very much in line with the recommendations of the Company Law Committee and introduced strong statutory legislaiton giving Government strong powers of control and inspection over the corporate sector. This was considered appropriate and necessary and fitted in with the general economic, political and social climate in the country at this time.

Interactions between the corporate system and accounting regulation in the Companies Act 1956

As well as trans-system activity between the parliamentary system and accounting regulation, trans-system activity was also seen between the corporate sector and accounting regulation. The corporate sector was very much affected by accounting regulation included in the Companies Act and therefore they tried to influence company law, including the accounting requirements, while the law was being promulgated. In the case of the Companies Act 1956, the corporate sector were active in trying to influence the Companies Act 1956 at all stages of its promulgation.

The Company Law Committee contained members of the corporate sector and hence the corporate sector had the opportunity to put forward their point of view in all the meetings of the committee. The corporate sector also sent written representations to the Government on the Memorandum issued by the Government in 1949. These representations, along with all other written representations received by the Government, were passed to the Company Law Committee for analysis. The Company Law Committee then invited some parties to give oral evidence to the committee. The corporate sector, both individual companies and chambers of commerce and trade associations operating on behalf of companies, were called to give oral evidence to the committee. 64 % of all the witnesses to the Company Law Committee were from the corporate sector, with most of the witnesses being members of trade and business associations, as shown in appendix 10.

At the joint committee stage too, the corporate sector were invited to give oral evidence to the joint committee. Employer's representatives, (the Employers Federation of India) and Chambers of Commerce (The Associated Chambers of Commerce of India) were invited to give evidence on behalf of the corporate sector on the Companies Bill 1953, as shown in appendix 11.

The corporate sector also lobbied members of parliament on the joint committee to present their point of view at the joint committee stage and lobbied members of parliament to argue their case in the parliamentary debates. (*interviews with senior*

government officials on 10th and 17th November 1998; interviews with senior members of the accounting profession on 3rd November 1998, 4th November, 9th November 1998, 17th November 1998, 18th November 1998 and 20th November 1998)

The representations to both the Company Law Committee and the Parliamentary Joint Committee and the lobbying of Parliament were made to try and reduce the regulations that the corporate sector had to follow. The corporate sector did have some success in this at both the Company Law Committee stage and the joint committee stage. For example

- keeping the ability of directors to refuse to transfer shares. *(Clause 34 of the Report of the Company Law Committee, 1952, amending Section 17 of the Indian Companies Act 1917)*

- requiring the registrar to appear before the court if he wanted to point out irregularities in the alteration of a company's memorandum and articles. *(Clause 15 of the Report of the Joint Committee, 1953, amending Section 17 of the Companies Bill 1953)*

- increasing the time for companies to submit annual returns to the registrar. *(Clause 65 of the Report of the Joint Committee, 1953, amending Section 159 of the Companies Bill 1953)*

- allowing companies to move their head offices if appropriate. *(Clause 63 of the Report of the Joint Committee, 1953, amending Section 145 of the Companies Bill 1953)*

- allowing companies to submit copies of documents to the registrar rather than submitting original documents. *(Clause 66 of the Report of the Joint Committee, 1953, amending Section 162 of the Companies Bill 1953)*

- giving companies the power to alter the voting system to appoint directors. *(Clause 85 of the Report of the Joint Committee, 1953, amending Section 225 of the Companies Bill 1953)*

However, at independence, there was a general feeling that the corporate sector did need strong regulation. This was due to three main reasons:

- during the war many companies had been run in ways which profited the management but not the other contributors to the companies i.e. capital and labour and this was felt to be unfair, especially with the political ideology of the Government of that time.

- it was felt that some companies were being run dishonestly by their managements and that these abuses needed to be stopped.

- it was felt that in, addition to the public sector, the private sector had an important role in national economic development. However, they needed to be regulated so that they did indeed contribute to economic development rather than run in ways that were detrimental to the national economic aims.

  (Report of the Company Law Committee, 1957 pages 3 to 12)

The Companies Act therefore contained many provisions which restricted the operations of companies and gave Government strong controlling powers over companies. These clauses were further strengthened at the joint committee stage. For example

- prohibiting companies from issuing shares with disproportionate voting rights. *(Clause 47 of the Report of the Company Law Committee, 1952, introducing new section of the Indian Companies Act 1913)*

- restricting contracts between directors or their associates and the companies and requiring disclosure of such transactions. *(Clause 96 to 99 of the Report of the Company Law Committee, 1952, amending Section 91 of the Indian Companies Act 1913)*

- specifying director's duties for example the number of board meetings which directors had to attend and the duties which they could not delegate. *(Clause 101 of the Report of the Company Law Committee, 1952, introducing new Section to the Indian Companies Act 1913)*

- specifying the notice period and conduct of annual general meetings. *(Clauses 72 to 79 of the Report of the Company Law Committee, 1952, amending Sections 77 to 86 of the Indian Companies Act 1913)*

- introducing powers of investigation over companies. *(Clauses 183 to 203 of the Report of the Company Law Committee, 1952, introducing new Sections to the Indian Companies Act 1913)*

- restricting the total remuneration of directors to a specified percentage of net profits of the company. *(Clause 75 of the Report of the Joint Committee, 1953, amending Section 197 of the Companies Bill 1953)*

- restricting the ability of companies to issue shares at a discount. *(Clause 36 of the Report of the Joint Committee, 1953, amending Section 78 of the Companies Bill 1953)*

- requiring all appointments of managing directors of public companies to be registered with the government. *(Clause 74 of the Report of the Joint Committee, 1953, amending Section 191 of the Companies Bill 1953)*

The Parliamentary debate stage saw no major changes to these proposals. *(Report of the Joint Committee, 1953, pages xxviii to lxii; Indian Parliamentary debate on the Companies Bill 1953, 5th to 10th September 1955)*

The corporate sector were concerned about many of these provisions and argued that, although they accepted that some control was necessary, the controls should not be so stringent such that they had no flexibility in how they operated. In particular, the corporate sector wanted more control over areas such as who was appointed as directors and how they were to be remunerated, a reduction in the bureaucracy that they had to follow and a reduction in Government powers over companies. *(Report of the Joint Committee, 1953, pages xxviii to lxii)*

However, the general feeling in India at this time was that strong regulation of the private sector was needed and that the best means for this was through statutory legislation which gave strong powers to the Government. This was very much in line with the cultural and social context of India in which strong regulation by Government and Parliament is expected. On the whole therefore, the corporate sector were unable to have most of the provisions of the Companies Bill 1953 changed in their favour and had to accept that Government would be involved very directly in many areas of corporate life. Indeed, the corporate sector did also accept that regulation was unavoidable due to the political scenario and the public perception of abuses in the corporate sector. In addition, the Government of India had indicated in their early industrial policies that there would be some protection for Indian companies against international competitors, for example tariff protection and licensing, and there was some feeling by companies that regulation in the Companies Act and by Government was acceptable in return for this protection. There was also some feeling of national pride in the corporate sector and the socialist ideals were accepted as worthy causes by some companies and regulation of the corporate sector was acceptable in order to achieve these aims. *(Chapters 4 and 5; interviews with senior accounting personnel in companies on 27th October 1998 29th October 1998, 2nd November 1998 and 5th November 1998; Financial reports of Indian companies for the years ended 1965 and 1969)*

From the above, it can be seen that the corporate sector were very active in trying to influence company law in their favour in the diffusion phase of the promulgation of the Companies Act 1956. However, at this point in time, there was a general feeling that companies needed to be strongly regulated by the Government to

ensure that they contributed to national economic development alongside Government initiatives to develop the economy with planning and the development of a strong public sector. The Companies Act therefore included many powers for the Government to regulate the corporate sector. The corporate sector did have some limited success in reducing the regulations but were unable to have most of these regulations reduced significantly.

Interactions between the legal profession and accounting regulation

The legal profession also significantly influenced the promulgation of the Companies Act 1956. Two legal experts were appointed by the Government from 1946 to 1950 to review the Indian Companies Act 1913 and indicate the lines along with the Act should be amended. The legal experts reported back to Government who then, based upon the reports of the legal experts, prepared a Memorandum, outlining possible amendments to the Indian Companies Act 1913. Although this Memorandum was criticised, the representations received by the Government on the Memorandum were used as the starting point for the work of the Company Law Committee.

The Company Law Committee was under the chairmanship of a retired judge and members of the legal professions (both solicitors and members of the bar) were represented on the committee. *(Report of the Company Law Committee, 1952, pages 4 to 5)*

In addition, the legal profession gave oral representations to the Company Law Committee. As well as being significantly represented on the Company Law Committee, the legal profession were the third largest group of witnesses called to give evidence to the committee. 5% of all witnesses to the Company Law Committee came from the legal profession, as shown in appendix 10 and, in general, they commented on the drafting of most of the provisions of the Bill.

The parliamentary joint committee also invited The Incorporated Law Society of India, and the Bombay Incorporated Law Society, representatives of the legal profession, to give their views on the Companies Bill. Hence the legal

profession influenced most of the provisions of the Companies Act that was eventually promulgated. The legal profession, however, were not major influences on the accounting and auditing provisions which were mainly left to the expertise of the accountants.

Interactions between the international system and accounting regulation

The Companies Act 1956 was also influenced by developments in company law in other countries particularly changes to company law in Britain in 1948. The Company Law Committee undertook a detailed comparison of British legislation and Indian legislation before making their recommendations. Many provisions were recommended to be changed in line with British legislation. These included:

- the requirement for the accounts to show a true and fair view. *(Clause 149 of the Report of the Company Law Committee, 1952, introducing new section to the Indian Companies Act 1913)*
- the provisions on the appointment of auditors *(Clauses 171 and 180 of the Report of the Company Law Committee, 1952, amending Sections 144 and 145 of the Indian Companies Act 1913)*
- the definition of "books of account" *(Clause 154 of the Report of the Company Law Committee, 1952, amending Section 130 of the Indian Companies Act 1913)*

Even where there were differences to British legislation, British legislation was discussed and the reasons for not following British legislation given. For example, even though the preparation of group accounts were not recommended, the issue was discussed and British legislation referred to. *(Clause 162 of the Report of the Company Law Committee, 1952)*

Britain still had a large influence over India due to its colonial history but changes in other countries, for example South Africa and the United States of America, also influenced accounting change in India. *(Report of the Company Law Committee, 1952, pages 3 to 15)*

Interactions between stock exchanges, shareholders representatives and employee representatives and the Companies Act

The stock exchanges and shareholder associations made representations to the Company Law Committee and to the Joint Committee. The stock exchanges made up 10% of the witnesses called to give evidence and shareholder associations made up 3.1% of the witnesses called to give evidence to the Company Law Committee, as shown in appendix 10. In addition, the Bombay Shareholder Association was called to give evidence to the joint committee on the Companies Bill 1953, as shown in appendix 11. The interests of the stock exchanges and the shareholder associations matched those of the Government who were keen to develop the capital markets and get shareholders more involved in the corporate sector. Thus the Government made changes which were generally in the interests of the stock exchanges and shareholder associations who therefore did not need to try and influence the process since there interests were already being taken into account.

Employees too made representations in the diffusion phase. 3.8% of the witnesses called to give evidence to the Company Law Committee were employee representatives, as shown in appendix 10, and the Indian National Trade Union Congress was called to give evidence to the joint committee, 1953, as shown in appendix 11. At this time, the employee representatives did not significantly influence the Companies Act. Employee issues were important in the newly independent India and were dealt with by the Government in other pieces of legislation and by using other measures.

The Reaction phase

The Companies Act 1956 became law on 1st April 1956. The Act was very long with over six hundred sections and twelve schedules and was criticised for the following reasons:

- the Companies Act was too long and too complex
- there was a lack of clarity in many of the provisions of the Act

- there was government involvement in corporate affairs, even in minor matters
- there was increased bureaucracy in the Act for example a large increase in the number of forms and returns required to be furnished by companies
- many loopholes has been left in the Act such that the effectiveness of the Act was reduced

(Report of the Joint Committee, 1953, pages xxviii to lxii; Report of the Company Law Amendment Committee, 1957, pages 4 to 6)

In response to the above criticisms the Government acted in two ways:

1 set up the Department of Company Law Administration to administer and enforce the Companies Act 1956. This had been recommended in the joint committee report in the diffusion phase but had not been included in the Companies Act 1956. Instead, under the Companies Act 1956, a Company Law Advisory Board had been set up to give advice on the administration and enforcement of the Act. *(Section 409 to 411 of the Companies Bill 1953)*

The Company Law Advisory Board consisted of three members who had expertise in company law, one of whom was a senior member of the ICAI. The Government stated that the Department of Company Law Administration would be responsible for the administration and enforcement of the Act but that it would obtain advice from the Company Law Advisory Board. It stated that in most cases it would take the advice of this Board. The Company Law Advisory body was later to become the Company Law Board and the Department of Company Law Administration was later to become the Department of Company Affairs.

2 set up an ad hoc committee, the Company Law Amendment Committee (known as the Shastri committee after its chairman) to review the Companies Act 1956 and make suggestions for its improvement. The Company Law Amendment Review committee prepared a report which was submitted to the Government in 1959. This report became the basis of the Companies Bill 1960 which was drafted by the Department of Company Law Administration with little change from the recommendations of the Company Law Amendment Committee. The Bill then went through the parliamentary process and became law in 1960. The parliamentary process included a joint committee review of the Bill and parliamentary debates on the Bill. However, there were only minor changes made to the recommendations of the Company Law Amendment Committee in the Companies Bill 1960, at both the joint committee stage and in the parliamentary debates on the Companies Bill 1960. The Bill received assent and became law, amending the Companies Act 1956 in 1960. *(Report of the Company Law Amendment Committee, 1957, pages 4 to 6; Das Gupta N., 1977, pages 14 to 17)*

Both intra-system activity and trans-system activity are seen in the reaction phase of the promulgation of the Companies Act 1956. Intra-system activity (activity between the regulatory institutions within the accounting system) occurred between the Department of Company Law Administration and accounting regulation and between the accounting profession (individual accountants, accounting firms and the ICAI) and accounting regulation. Trans-system activity (activity between social systems neighbouring the accounting system and the accounting system) occurred between the parliamentary, corporate and legal systems and accounting regulation in the Companies Act 1956. Both intra-system activity and trans-system activity are discussed below.

Intra-system activity

Interactions between the Department of Company Law Administration and accounting regulation in the Companies Act 1956

The Department of Company Law Administration was set up under the Ministry of Finance in 1957 and immediately assumed responsibility for the administration of the Companies Act. The Department of Company Law Administration was important in the revision of the Companies Act 1956.

The Department of Company Law Administration set up the Company Law Amendment Committee and set its terms of reference. These were to suggest amendments to simplify the Act, remove loopholes and clarify ambiguities. The Joint Secretary of the Department of Company Law administration was one of the four members of the Company Law Amendment Committee and as such was able to directly influence the first revision of the Companies Act 1956 by presenting the Government's point of view. In their review of the Companies Act, the Company Law Amendment Committee recommended changes to many of the provisions to try and make them work as had been intended and as desired by the Department of Company Law Administration. On the whole, changes were recommended to tighten the provisions where the provisions were not precise enough, such that Government powers could be exercised more effectively and companies regulated more strongly. For example

- the loophole of companies delaying their AGM in order to delay submitting returns to the registrar was removed. *(Clause 65 of the Report of the Company Law Amendment Committee, 1957, amending Section 166 of the Companies Act 1956)*

- a requirement for directors to keep records of all share transfers was introduced as it has been found that records of share transfers were not being kept by companies. *(Clause 66 of the Report of the Company Law Amendment Committee, 1957, amending Section 163 of the Companies Act 1956)*

- clarification that it was the directors responsibility to maintain company records for eight years. This was in response to records being destroyed by companies. *(Clause 88 of the Report of the Company Law Amendment Committee, 1957, amending Section 209 of the Companies Act 1956)*

- increasing the powers of the Registrar for example empowering the Registrar to compel companies to provide documents and explanations within reasonable time periods. *(Clause 99 of the Report of the Company Law Amendment, 1957, Committee, amending Sections 235 to 251 of the Companies Act 1956)*

However, the Governments view was not always accepted. For example the Department of Company Law Administration:

- wanted the right to inspect companies at any time. *(Clause 88 of the Report of the Company Law Amendment Committee, 1957)*

- wanted companies to have uniform year ends. *(Clause 89 of the Report of the Company Law Amendment Committee, 1957).*

- wanted to have the power to appoint auditors for companies *(Clause 95 of the Report of the Company Law Amendment Committee, 1957)*

These proposals were all rejected by the Company Law Amendment Committee as they considered that they were too onerous on the corporate sector, would give unnecessary powers to Government and would introduce too many rigidities into the system. But, as outlined above, in most cases the Company Law Amendment Committee did accept the wishes of the Government, and clarified many provisions of the Companies Act 1956 to stop companies interpreting the Act in ways which were not deemed desirable by the Government and to stop outright abuses of the Act.

The Company Law Amendment Committee reported back to Government in 1959. Based on their report, the Department of Company Law Administration drafted the Companies Bill 1960, which was the first amendment Bill to revise

the Companies Act 1956. The Companies Bill 1960 was reviewed by a joint committee and then debated in both Houses of Parliament. At both these stages only minor changes to the Companies Bill 1960 took place. The Bill received assent in 1960 and became law, amending the Companies Act 1956 on 1 April 1960. *(Das Gupta N., 1977, pages 14-17).*

From the above it can be seen that the Department of Company Law Administration was very influential in the promulgation of the Companies Amendment Bill 1960, the first major revision to the Companies Act 1956. They set up the Company Law Amendment Committee, set its terms of reference, the Joint Secretary of the Department of Company Law Administration was a member of the Company Law Amendment Committee, the Department of Company Law Administration drafted the Companies Bill 1960 which became law with only minor changes at the joint committee and parliamentary debate stages. Most of the recommendations of the Company Law Committee were very much in line with the wishes of the Department of Company Law Administration and the Government.

Interactions between the Institute of Chartered Accountants of India and accounting regulation in the Companies Act 1956

The accounting profession (individual accountants, accounting firms and the ICAI) were again important in the reaction phase of the promulgation of the Companies Act 1956. A senior member of the ICAI was one of the four members of the Company Law Amendment Committee and hence was actively involved and influential in the review of the Companies Act and in making suggestions to improve the operation of the Act.

As for the diffusion phase, individual chartered accountants, accounting firms and the ICAI sent written representations to the Company Law Amendment Committee and some accountants were invited to give oral evidence to the Company Law Amendment Committee. 5% of the written representations and 8% of the oral representations were from the accounting profession, the second largest lobbying group after the corporate sector, excluding individuals whose

associations could not be identified. In addition, at this stage, the ICAI sent a memorandum to the committee which contained a review of the accounting provisions and schedules with suggestions for amending these. The ICAI recommended minor changes to the format and wording of the balance sheet and recommended two extra disclosures in the directors' report. *(Report of the Company Law Amendment Committee, pages 189 to 193)*

Some changes to the auditing provisions were also proposed. For example, audit firms were allowed to sign audit reports in their own name and auditors were required to give reasons for qualifications in audit reports. *(Clause 95 of the Report of the Company Law Amendment Committee, amending section 225 of the Companies Act 1956)*

The recommendations of the ICAI were fully accepted by the Company Law Amendment Committee. The changes proposed by the ICAI became part of the recommendations in the Company Law Amendment Committee report and later part of the Companies Amendment Bill 1960.

The accounting profession were also influential in preventing some provisions from being promulgated for example they stopped the government gaining powers to appoint company auditors and stopped provisions whereby auditors would not be allowed to provide other services such as tax advice and consultancy to companies which they audited. *(Clause 95 of the Report of the Company Law Amendment Committee, 1957)*

The ICAI also managed to remove a section which would have allowed accountants trained before the ICAI was set up to become members of the ICAI without passing the examinations and other requirements of the ICAI. *(Clause 95, of the Report of the Company Law Amendment Committee, 1957)*

Not all the proposals made by the Company Law Amendment Committee were in line with the wishes of the accounting profession and the ICAI. There were some restrictions placed on the accounting profession. Even though the audit firms were allowed to sign audit reports with the name of the firm, they still had to inform the registrar of the individual auditor who was responsible for the audit. It was also expressed by the Government that the ICAI would be expected

to ensure the independence of auditors. However, on the whole, the accounting profession, especially the ICAI, influenced the revision of the Companies Act 1956 in their own favour quite considerably at the Company Law Amendment Committee review stage. They argued strongly that accounting and auditing matters should be left to the ICAI which would ensure that accounting was of a high standard and that auditors would be tightly regulated. At this time, the ICAI was still a relatively new institute and most people generally agreed that accounting and auditing should be left in the hands of the Institute wherever possible. *(Report of the Joint Committee, 1953, pages xxviii to lxii; Report of the Company Law Amendment Committee pages 189 to 193; Kapadia G.P., 1972, pages 297 to 298; interviews with senior accounting personnel in companies on 27th October 1998, 29th October 1998, 2nd November 1998 and 5th November 1998; interviews with senior government officials on 10th and 17th November 1998; interviews with senior members of the accounting profession on 3rd November 1998, 4th November, 9th November 1998, 17th November 1998, 18th November 1998 and 20th November 1998)*

There were some indications that the ICAI were not without critics. There were some criticisms of the ICAI by the Department of Company Law Administration in the areas of auditors giving clean audit certificates when they should not have and not adequately dealing with the requirement for accounts to give a true and fair view. *(Editorial, Chartered Accountant vol viii, May 1960, pages, 429 to 431)*

However, these criticisms were not wide spread and were made outside the processes which were directly related to the reaction phase of the promulgation of the Companies Act 1956 and did not affect the influence of the accounting profession in the reaction phase.

The ICAI was the only accounting institute which was significantly involved in the reaction phase of the promulgation of the Companies Act 1956. The Institute of Cost and Works Accountants of India (ICWAI) had only recently obtained its charter and the Institute of Company Secretaries of India (ICSI) were only just starting and hence there was no significant lobbying influence by the ICWAI and the ICSI.

Trans-system activity

Interactions between Parliament and accounting regulation in the Companies Act 1956

Accounting regulation has always been directly influenced by Parliament since accounting provisions have been included in Companies Acts which have promulgated through the parliamentary system. This influence was also seen in the reaction phase of the promulgation of the Companies Act 1956 since the changes to the Companies Act 1956 were included in an amendment Bill to the Act which was promulgated through the parliamentary process. The Companies Bill 1960 was drafted by the Department of Company Law Administration, and then went through the normal parliamentary process. The Bill was introduced in Parliament in 1959, was reviewed by a joint committee and then debated in both Houses of Parliament. Members of Parliament had the opportunity to influence the provisions of the Bill at both the joint committee stage and at the parliamentary debate stage of the promulgation of the Bill. However, only minor changes were made to the Bill during the joint committee review and the parliamentary debates, and it received assent and became law on 1 April 1960. *(Das Gupta N., 1977, pages 14 to 17)*

Therefore, in common with the promulgation of the Companies Act 1956, the promulgation of the first Companies Amendment Bill to the Act, a direct reaction to the problems and criticisms of the Companies Act 1956, went through the parliamentary system. The parliamentary system therefore had the opportunity to directly influence the provisions of the Companies Bill 1960 and the Companies Act 1956.

Interactions between the corporate system and accounting regulation in the Companies Act 1956

As in the diffusion phase, the corporate sector influenced the changes made to the Companies Act in the reaction phase of the promulgation of the Companies Act 1956.

The corporate sector influenced the changes both directly, with a company director being one of the members of the Company law Amendment Committee and indirectly by sending representations to the Company Law Amendment Committee. Representations were sent by both companies and trade associations and chambers of commerce and some of these parties were called to give oral evidence to the Company Law Amendment Committee. The corporate sector was the largest lobbying group and they lobbied both directly and through chambers of commerce and other trade associations. 37% of the written representations and 31% of the oral representations, excluding individuals whose associations could not be identified, came from the corporate sector. Some of these representations came from individual companies, but most of the representations came through chambers of commerce and trade associations such as the Federation of Indian Chambers of Commerce and the Associated Chambers of Commerce, as shown in appendix 13.

The recommendations made by the Company Law Amendment Committee did take into account some of the concerns of the corporate sector. For example

- reduced some of the administrative burden in sending information to the registrar. *(Clause 65 of the Report of the Company Law Amendment Committee, 1957, amending Section 159 of the Companies Act 1956)*
- not allowing the government to have the right of inspection of company records at all times. *(Clause 88 of the Report of the Company Law Amendment Committee, 1957, amending Section 209 of the Companies Act 1956)*
- allowing companies to store records away from the registered office. *(Clause 67 of the Report of the Company Law Amendment Committee, 1957, amending Section 163 of the Companies Act 1956)*
- allowing companies to hold general meetings away from the registered office. *(Clause 69 of the Report of the Company Law Amendment Committee, 1957, amending Section 166 of the Companies Act 1956)*

However, at this time, there was still a general feeling that the corporate sector had to be tightly controlled. The recently formed Department of Company Law Administration, who were represented on the Company Law Amendment Committee, were more influential than the corporate sector. Most of the recommendations of the Company Law Amendment Committee were in line with the wishes of the Department of Company Law Administration and

generally increased their control over companies. The corporate sector did try to influence the revision of the Companies Act through making representations to the committee but had limited success in this, possibly due to the social, economic and political scenario of India at this point in time.

Interactions between the Legal system and accounting regulation in the Companies Act 1956

As for the diffusion phase, the legal profession were also involved in the reaction phase of the promulgation of the Companies Act 1956. One of the members of the Company Law Amendment Committee was a solicitor and the chairman of the Company Law Committee was a retired judge.

The legal profession made representations to the Company Law Amendment Committee on the drafting and operation of many of the provisions of the Companies Act 1956. 9% of the written representations and 18% of the oral representations were from the legal profession making them the third largest lobbying group, excluding individuals whose associations could not be identified. However, as for the diffusion phase, they did not influence the accounting provisions, which were mainly influenced by the accounting profession and the ICAI.

Interactions between stock exchanges, shareholders representatives and employee representatives and the Companies Act

The stock exchanges did not make any representations to the Company Law Amendment Committee, perhaps due to the fact that separate legislation, the Securities and Contract Act 1949, was promulgated which more directly affected the stock exchanges. *(The Securities and Contracts Act, 1949)*

Shareholder associations made representations to the Company Law Amendment Committee. 5.7 % of the written representations and 14.3 % of the witnesses called to give evidence to the committee were from shareholder associations, as shown in appendix 13. In general, the Government made changes which were in

the interests of shareholders associations, as the interests of the shareholders and the Government were close at this time.

Employees did not make many representations to the Company Law Amendment Committee. Only 0.4% of the written representations to the Company Law Committee were from employees and no employee associations gave oral evidence to the Company Law Committee, as shown in appendix 13.

Culture and Social Context.

Culture and social context are important in the source, diffusion and reaction phases of the promulgation of the Companies Act 1956. Some of the characteristics of the cultural and social context of India are:

- a hierarchical society
- a family based system with heads of the family looking after the members of their extended family
- high collectivism, low uncertainty avoidance, high masculinity and high power distance
- strong British influence on India - both with British institutions inherited at independence after a long period of colonisation and with British influence remaining subsequent to colonisation. For example, the legal system and the parliamentary system in India is very much based on the British model.
- a mixed economy with the aims of social justice and public interest in all social systems
- acceptance that law is an appropriate means of regulating companies and that there will be strong Government involvement in all social systems, including the accounting system and the corporate sector.

(Chapters 4 and 5)

The cultural and social characteristics outlined above indicate that statutory control and government control will be an important means of regulation in India. It is therefore expected that accounting, as one of the social systems of the country, will be affected by strong statutory control promulgated through the parliamentary system and strong regulation by government institutions will be seen. This is

indeed what was seen in the changes to the regulation of the corporate sector at independence. India chose to retain the use of a Companies Act to regulate companies and accounting regulation was a key component of the Companies Act. The Companies Act was promulgated through the parliamentary system and contained many provisions which gave Government strong powers of control over companies.

Culture and social context are important in all three phases of the promulgation of the Companies Act 1956. The cultural and social context was important in the source phase of the promulgation of the Companies Act 1956 as the need to change the Companies Act was related to the economic, political and social aims of the country with accounting seen as an important tool in achieving these aims. The problems that needed to be tackled came from the socio-economic context of India and the Companies Act 1956 was promulgated to help achieve the social, economic and political aims of India. Rapid economic development with socialist ideals was one of the main aims and the corporate sector was to be regulated to try and ensure that companies were honestly run and that they contributed to social and economic objectives. In addition, the Government were keen to try ensure fairness between the different parties interested in companies (i.e. capital, labour and management) which led to provisions such as restricting the remuneration of directors, improving accounting disclosure to give shareholders more information on companies and reform of the managing agency system which had not worked fairly.

In India, the British legacy was also important in determining the form of accounting regulation that was seen. The Companies Act had been inherited as the primary means of regulating company affairs, and at independence, the Indian Government chose to use the same means of regulating companies. The Companies Act was retained as a key means of regulation, a form of regulation which was in line with what was expected with the cultural and social context of India. The Companies Act was however revised to take into account the social and economic needs of India, rather than the needs of Britain. However, even after independence, Britain continued to influence the Companies Act as the changes to the Companies Act were very much influenced by the Cohen Committee report and the British Companies Act of 1948. Other countries such as South Africa and the

United States of America influenced the Companies Act too but the greatest influence on the Companies Act 1956 was that of Britain.

The cultural and social context of India was also important in the diffusion and reaction phases of the promulgation of the Companies Act 1956. In both the diffusion and reaction phases of the promulgation of the Companies Act 1956, culture and social context determined the problems that needed to be regulated and also the processes and institutions used to promulgate the regulatory changes. In India, the Companies Act promulgated through the parliamentary system, was chosen as the best means for promulgating regulatory changes including changes to accounting regulations. Furthermore, when problems in the operation of the Companies Act 1956 arose after its initial promulgation, the Government continued to use the Companies Act but amended it, again using the parliamentary system. The Companies Act 1956 was first amended by the Companies Bill 1960. Thereafter, amendment Bills revising the Companies Act 1956 were passed periodically. The Companies Amendment Bills which most affected the accounting provisions were the Companies Amendment Bill 1974 and the Companies Amendment Bill 1988. A major revision to the Companies Bill 1956 was also planned in 1997 but was never promulgated. These amendment Bills will be analysed in the next chapters.

In addition, strong government control is expected in all social systems in India including the accounting system. Strong statutory control of accounting is seen with accounting regulation being an important part of the Companies Act. The Companies Act gave strong powers to Government to control and investigate companies and the Government set up important institutions, the Department of Company Law Administration and the Company Law Advisory Board, to control the corporate sector including accounting by the corporate sector.

As discussed above, culture is seen to be an important factor affecting accounting with culture and social context playing an important role in accounting and accounting change in all three stages of the change, the source phase, the diffusion phase and the reaction phase.

Politics and accounting change

From the above analysis, accounting change can be seen to be very political. Accounting is political in the sense that Government and Parliament are actively involved in accounting change. In India, accounting regulations are incorporated into the Companies Act, which is drafted by Government and goes through the parliamentary process.

In addition, accounting is very much surrounded by political processes. The outcome of any accounting change is seen to be the outcome of the lobbying and debate process between all parties interested in accounting. In this case, the interactions took place within the parliamentary process and was overseen by the Government. The parties most affected by accounting are the ones most active in the lobbying process and these are identified to be the Government itself, the parliamentary system, the corporate sector, the accounting profession, particularly the ICAI, and the legal profession. Of these the Government and the ICAI are seen to be the most influential. The corporate sector, although making the most written and oral representations, was less successful in changing the Companies Act 1956 in their favour. This may be due to the social, political and economic context of India at the time and the general perception that the corporate sector did need strong regulation which would best be achieved by statutory legislation giving strong regulatory powers to Government institutions.

Summary and Conclusions

The promulgation of the Companies Act 1956 can be analysed, using the theoretical framework proposed in chapter 3, into three phases, a source phase, a diffusion phase and a reaction phase. Changes to the accounting system are initiated by events and institutions outside the accounting system, in this case, due to government initiatives to try and improve the economy and achieve certain social and political objectives. The diffusion and reaction phase of the change are composed of intra-system activity and trans-system activity. Intra-system activity

occurred between the Government and accounting regulation and the accounting profession (individual accountants, accounting firms and the ICAI) and accounting regulation in both the diffusion and reaction phases of the change. Trans-system activity occurred between the parliamentary system, the corporate sector and the legal system and accounting regulation, again in both the diffusion and reaction phases of the change.

In addition, international factors were important in influencing accounting change in the diffusion phase of the change. The Companies Act 1956 was very much influenced by the Cohen Commission review of company law in Britain and the British Companies Act 1948.

Culture and social context is seen to be important in all three phases of the change and the whole process of change is surrounded by political processes. The change is initiated for social and economic reasons which determine what problems need to be tackled and the institutions and processes used to tackle these processes. Accounting is political as accounting change is influenced by Parliament and Government and is the result of interactions between the different parties interested in accounting. These parties are identified as the Government, Parliament, the corporate sector, the accounting profession, the legal profession and the international system. All of these try and influence accounting change in both the diffusion and reaction phase and the most successful are the Government and the accounting profession.

The above analysis shows the importance of understanding the historical and cultural context of a country when investigating the development of its accounting system and not just looking at accounting isolation. Both cultural and political processes are important in influencing accounting change and the theoretical framework proposed is shown to be useful in analysing the accounting changes in the Companies Act 1956.

The short term reaction to the promulgation of the Companies Act 1956 is discussed in this chapter. In the longer term, the Companies Act 1956 underwent many changes and was revised many times. Revisions of the Act which

incorporated major accounting changes took place in 1974 and 1988. In addition, major revisions were put into process in 1997 but were never completed. These longer term reactions to the promulgation of the Companies Act 1956 are analysed in the next chapters.

Chapter 7

The Promulgation of the Companies (Amendment) Bill 1974

Introduction

After is promulgation in 1956, the Companies Act was reviewed by the Company Law Amendment Committee and amended, using the parliamentary system in 1960. This first review can be regarded as the immediate reaction to the promulgation of the Companies Act 1956. There were no major changes to the Companies Act 1956 in the 1960's and the next major change to the Companies Act 1956 took place in the 1970's with the promulgation of the Companies (Amendment) Bill 1974. This Bill can be regarded as part of the longer-term reaction to the promulgation of the Companies Act 1956 and is discussed below.

The Process for Promulgating the Companies (Amendment) Bill 1974

The promulgation of the Companies (Amendment) *Bill 1974*, which amended the Companies Act 1956, started in 1972 as the Companies Bill 1972. The Bill was initiated by Government, drafted by officials of the Department of Company Affairs (DCA) and introduced into Parliament in August 1972. The Bill was then immediately referred to a joint committee of Rajya Sabha and Lok Sabha by Parliament for review. The joint committee on the Companies (Amendment) Bill consisted of the following members:

- 30 members of Lok Sabha (including the chairman)
- 15 members of Rajya Sabha
- 2 members of Legislative council
- 3 members of the Ministry of Law, Justice and Company Affairs

(Indian Parliamentary debates on Companies (Amendment) Bill 1974 on 2nd, 5th, 19th and 22nd August 1974; Report of the Joint Committee on the Companies (Amendment) Bill 1974, pages v to vi)

The members of both the Lok Sabha and the Rajya Sabha were chosen to represent both the party in government and the opposition parties and to represent as many different viewpoints on the Companies Act as possible. *(Report of the Joint Committee on the Companies (Amendment) Bill 1974, pages v to vi, xvii to xxix)*

The joint committee invited memoranda from various chambers of commerce, industry associations, professional organisations and individuals interested in the subject matter of the Bill. The joint committee received 130 memoranda from parties interested in the Bill and called some of these parties to give evidence before the committee. The joint committee also requested some parties who had not made written submissions to give evidence to the committee, for example representatives of government departments and representatives of public financial institutions, as they were considered to have an important interest in the Companies Act. A list of parties who made written submissions to the committee and the parties who gave oral evidence to the joint committee are given in appendices 14 and 15. *(Report of the Joint Committee on the Companies (Amendment) Bill 1974, pages v to vi, xvii to xxix)*

The Bill was extensively debated at the joint committee stage and this took much longer than expected. The Joint committee was initially expected to report back to Parliament in November 1972. However the Bill was very long and complex and the reporting deadline for the joint committee was extended several times. The joint committee eventually reported back to Parliament on 16 November 1973. The Bill was then debated three times in the Rajya Sabha and three times in the Lok Sabha, before being promulgated in 1974 as the Company (Amendment) Bill 1974.

The main provisions of the Companies (Amendment) Bill 1974 included:

- tightening the defining "groups" and "under the same management". *(Clauses 2 and 4 of the Companies (Amendment) Bill 1974, amending Sections 18 and 43 of the Companies Act 1956)*
- laying down criteria for the ownership of public limited companies. *(Clause 5 of the Companies (Amendment) Bill 1974, amending Section 73 of the Companies Act 1956)*

- introducing provisions relating to the taking of public deposits by companies. *(Clause 6 of the Companies (Amendment) Bill 1974, introducing new Section into the Companies Act 1956)*

- introducing provisions relating to dividend payments by companies. *(Clauses 14 and 18 of the Companies (Amendment) Bill 1974, amending Section 205 of the Companies Act 1956)*

- introducing provisions preventing companies entering into contracts in which directors were interested. *(Clause25 of the Companies (Amendment) Bill 1974, amending Section 297 of the Companies Act 1956)*

- introducing provisions preventing relatives of directors earning more than a specified amount from the company. *(Clause 29 of the Companies (Amendment) Bill 1974, amending Section 314 of the Companies Act 1956)*

- requiring companies to identify all higher paid employees in the company and indicate whether they were relatives of directors. *(Clause 22 of the Companies (Amendment) Bill 1974, amending Section 217 of the Companies Act 1956)*

- introducing cost audit requirements. *(Clause 25 of the Companies (Amendment) Bill 1974, amending Section 233 of the Companies Act 1956)*

- introducing the requirement for companies to employ company secretaries. *(Clause 30 of the Companies (Amendment) Bill 1974, introducing new Section into the Companies Act 1956)*

- introducing a ceiling on the number of audits that any one auditor could perform. *(Clause 20 of the Companies (Amendment) Bill 1974, amending Section 224 of the Companies Act 1956)*

- discussing the possibility of introducing auditor rotation. *(Clause 20 of the Companies (Amendment) Bill 1974)*

- placing a duty on directors provide books of account and information to officers of the government when requested to do so. *(Clause 20 of the Companies (Amendment) Bill 1974, amending Section 209 of the Companies Act 1956)*

- increasing the powers of the Government and of the Company Law Board. *(Clause 20 of the Companies (Amendment) Bill 1974, amending Sections 17, 18, 19, 79, 141 and 186 of the Companies Act 1956)*

During the parliamentary debates there was support for the Companies (Amendment) Bill 1974 from some members of parliament, who considered that the aims of the government would be achieved by the Bill. In their opinion, the Bill would help control monopolistic companies, would help improve the efficiency of the corporate sector leading to better economic growth, would help improve the administration of the Act and would tackle corporate sector abuses. *(Report of the Joint Committee on the Companies (Amendment) Bill 1974, pages v to vi, xvii to*

xxix; Indian Parliamentary debates on Companies (Amendment) Bill 1974 on 2nd, 5th, 19th and 22nd August 1974)

However there were also criticisms of the Bill which included arguments from parties who supported business and parties who were against business. The pro business lobby, mainly the corporate sector, stock exchanges and the accountancy profession, generally wanted less government involvement in the corporate sector. The anti business representatives, mainly employee representatives and members of parliament in the communist party, criticised the Bill as supporting business to the detriment of other stakeholders, such as employees, in society. The arguments against the Bill are detailed later in the chapter.

The criticisms of the Companies (Amendment) Bill 1974 were taken into account at the joint committee stage and the parliamentary debate stage of the promulgation of the Bill, and some amendments to the Bill were made at both stages. After the Bill was debated in Parliament, it received parliamentary assent and became law on 10th September 1974.

The Promulgation of the Companies (Amendment) Bill 1974 can be analysed into source, diffusion and reaction phase, using the theoretical framework proposed in chapter 3, as discussed below:

Analysis of the promulgation of the Companies (Amendment) Bill 1974

The source phase

No single intrusive event occurred which led directly to the promulgation of the Companies (Amendment) Bill 1974. Instead there were general government concerns about the need to improve poor economic and social performance and the need to control the corporate sector more effectively. The main reasons for amending the Companies Act 1956 were given by Government and Parliament as follows:

- to streamline the administration of the Companies Act 1956 and to promote greater efficiency and social justice in the working of the corporate sector. This included the need to increase professional management in companies, to try and ensure that companies employed the most qualified, experienced and suitable employees and to promote independence between auditors and companies.

- to stop abuses in the corporate sector such as companies taking deposits from the public and absconding with the money, dividends not being paid in a timely and appropriate fashion and related party transactions. Examples of related party transactions were the employment of relatives in high positions for which they were not qualified and the awarding of favourable contracts to relations and companies under the management of the directors to the detriment of the company.

- to control the increasing concentration of economic power in the corporate sector. Large monopolistic businesses (often family owned and run) had developed and one way these businesses had arisen was through take-overs of smaller companies by a few large Indian businesses. A particular concern was to curb economic power in the hands of private monopoly capital without destroying entrepreneurial initiative.

- to improve low productivity, efficiency and output in the economy.

- to deal with foreign exchange deficits and problems.

(Report of the Joint Committee on the Companies (Amendment) Bill 1974, pages v to vi, xvii to xxix; Indian Parliamentary debates on Companies (Amendment) Bill 1974 on 2nd, 5th, 19th and 22nd August 1974)

The government chose to tackle the problems outlined above using a variety of measures, one of which was to amend the Companies Act 1956. This was done through promulgating the Companies (Amendment) Bill 1974 which amended the 1956 Companies Act.

The Companies (Amendment) Bill 1974 was initiated by government due to their concerns for economic growth, social development and control of the corporate sector. The source of the change therefore came from outside the accounting system and reasons for the change related to wider social and economic issues, as outlined above. Accounting regulation was included in the Companies Act as it was perceived to be a tool that could be used to help economic development and hence important for society as a whole and not just

the domain of accountants. Indeed the role of accounting in economic and social development and the role of the accounting profession in economic and social development were recognised by Government and the accounting profession in India at this time. *(Editorial, Chartered Accountant, Vol xix, September 1970, pages 417-429; President's page, Charted Accountant, Vol xix, December 1970, pages 471 to 472; President's page, Charted Accountant, Vol xix, December1970, pages 83-84; Bhandari M.V., Chartered Accountant, Vol xix , September 1971 , pages 213-217; Bhaduri R., and Shah O.P., Chartered Accountant, Vol xx , June 1972, pages 1042-1047)*

Statutory regulation and regulation by government bodies was chosen as the most appropriate means of regulating the corporate sector including accounting regulation. This is very much in line with what is indicated by the culture of the country. In India, statutory control and control by government bodies are expected to be important, perhaps the most important, regulatory means in the country.

The Diffusion Phase

The Companies (Amendment) Bill 1974 was promulgated to try and deal with the socio-economic problems faced by India in the 1970's as outlined above. As with any act of parliament, the Companies (Amendment) Bill 1974 went through the parliamentary process which included:

- proposal of legislation by the Government.
- drafting of the legislation by the most appropriate government department, in this case the DCA.
- proposal of draft legislation in Parliament, sometimes with debates on the legislation with no committee review and sometimes referral to a committee for review. In this case the draft legislation was referred to a joint committee of the Lok Sabha and the Rajya Sabha for review without initial debate in Parliament.
- review of legislation by a committee of Parliament if appropriate. In this case the draft Bill was reviewed by a joint committee of the Lok Sabha and the Rajya Sabha. The joint committee discussed the draft Bill on a provision by provision basis and made changes to the Bill after obtaining both written submissions and oral evidence from all parties interested in

the Bill.

- presentation of the revised Bill to Parliament and debate of the Bill in Parliament, three times in the Lok Sabha and three times in the Rajya Sabha. Final amendments to the Bill are proposed and voted upon. In this case only minor changes were made to the Bill at the final debate stage.

- voting on the legislation in Parliament and assent given to the legislation, if accepted by Parliament, by the President of India. In this case, the Companies (Amendment) Bill 1974 received assent and became law on 10th September 1974.

(Chapter 4; interviews with senior Government officials on 10th November 1998 and 17th November 1998)

Both intra-system activity and trans-system activity are seen in the promulgation of the Companies (Amendment) Bill 1974. Intra-system activity, activity between different regulatory bodies within the accounting system, is seen between the DCA and legal accounting regulation and between the accounting profession in India and legal accounting regulation. Trans-system activity is seen between social systems neighbouring the accounting system and the accounting system itself. In this case, trans-system activity is seen mainly between the parliamentary system, the corporate system and employee representatives and legal accounting regulation

Both intra-system activity and trans-system activity are discussed below.

Intra-system activity

Interactions between the DCA and accounting regulation in the Companies Act

The Department of Company Affairs (DCA), under the Ministry of Law, Justice and Company Affairs, was involved in the promulgation of the Companies (Amendment) Bill 1974 in all stages of the promulgation of the Bill. Officials of the DCA were responsible for drafting the initial legislation that was proposed in Parliament and reviewed by the joint committee. Hence the DCA decided

what would be included in the Companies (Amendment) Bill 1974 and what would be discussed by all parties in the process for promulgating the Bill. *(Report of the Joint Committee on the Companies (Amendment) Bill 1974, pages v to vi, xvii to xxix; Indian Parliamentary debates on Companies (Amendment) Bill 1974 on 2nd, 5th, 19th and 22nd August 1974; interviews with senior Government officials on 10th and 17th November 1998)*

In addition officials of the DCA were members of the joint committee to review the legislation and other members of the DCA also gave evidence to the joint committee. These representatives presented the government's reasoning for particular clauses of the Bill and were asked to give an indication of governments reaction to the changes proposed by the joint committee, before the any changes were made by the joint committee. Any changes that were not supported by the Government and the DCA were not generally included in the Companies (Amendment) Bill. Finally, the Minister of Law, Justice and Company Affairs introduced the Companies (Amendment) Bill into Parliament and, together with the DCA, steered the Bill, through the parliamentary system. *(Report of the Joint Committee on the Companies (Amendment) Bill 1974, pages v to vi, xvii to xxix; Indian Parliamentary debates on Companies (Amendment) Bill 1974 on 2nd, 5th, 19th and 22nd August 1974; interviews with senior Government officials on 10th and 17th November 1998)*

As well as being important in the process for promulgating the Companies (Amendment) Bill 1974, there was an increase in the powers of the Government over the corporate sector in the Bill itself. There was both an increase in the direct control of the corporate sector by the Government and indirect control by the Company Law Board (CLB), a Board set up under the DCA in 1963 to regulate the compliance of the corporate sector with the Companies Act. For example

- restrictions were placed on the acquisition of shares of public companies by individuals and private limited companies and government approval was required for the transfer of some shares. *(Clause 10 of the Companies (Amendment) Bill 1974 amending Section 108 of the Companies Act 1956)*

- directors had a duty to provide books of account and information to officers of the government when requested to do so. This significantly increased government inspection powers and it was hoped that this would help enforce the provisions of the Companies Act. *(Clause 20 of the Companies (Amendment) Bill 1974 amending Section 209 of the Companies Act 1956)*

- introducing a schedule listing important industries where there was strong public interest. The Bill gave government wide powers to regulate these public interest industries. *(Clause 41 of the Companies (Amendment) Bill 1974 inserting schedule xiii into the Companies Act 1956)*

- increasing the powers of the Company Law Board to regulate the corporate sector. The Company Law Board had been set up by the Companies Act 1956 as an advisory Board in 1963. By 1974 the CLB was no longer advisory and dealt with the administration and enforcement of the Companies Act 1956. The CLB was not however an independent body and operated under the supervision of the DCA. *(Clause 20 of the Report of the Joint Committee on the Companies (Amendment) Bill 1974, amending Clauses 5, 9, 13 and 14 of the revised Companies (Amendment) Bill 1974, amending Sections 17, 18, 19, 79, 141 and 186 to the Companies Act 1956)*

There was much support for these measures. There was a general acceptance that the corporate sector needed to be controlled effectively and that this would best be done by the Government. This is very much in line with what is expected in India with its culture and social context. This also very much fitted in with the political and economic ideology of the time, which was to achieve economic development with social justice within a mixed economy. This ideology was accepted in India as appropriate and was supported by some members of the corporate sector, who recognised that some level of control was appropriate in order to achieve economic and social development. *(Chapter 4; Report of the Joint Committee on the Companies (Amendment) Bill 1974, pages v to vi, xvii to xxix; Indian Parliamentary debates on Companies (Amendment) Bill 1974 on 2nd, 5th, 19th and 22nd August 1974; Financial reports of Indian companies for the years ended 1965 and 1969)*

However the measures were not without criticisms, both by the corporate sector and by those against the corporate sector. The corporate sector argued that the Bill gave too much power to the government and would lead to too much bureaucracy and interference in the affairs of companies. The anti-business lobby argued that the Bill was very much in favour of business at the expense of employees and other stakeholders in society. The criticisms against the Bill are detailed later in the chapter, under trans-system activity. *(Report of the Joint Committee on the Companies (Amendment) Bill 1974, pages v to vi, xvii to xxix; Indian Parliamentary debates on Companies (Amendment) Bill 1974 on 2nd, 5th, 19th and 22nd August 1974; Lall R.M., and Mittal S.R., Chartered Accountant, Vol xxii, September, 1973, pages 121 to 124; Gupta S.K., Chartered Accountant, Vol xxii, January 1974 pages 372-379)*

During the joint committee stage some changes to the provisions of the Companies Bill were made, in response to the criticisms of the Bill. For example

- some of the government powers were given to the CLB, thereby reducing some of the direct control of the government over the corporate sector. *(Clause 20 of the Report of the Joint Committee on the Companies (Amendment) Bill 1974 amending Sections 17, 18, 19, 79, 141 and 186 to the Companies Act 1956)*

- a right of appeal to the courts against the decisions of the CLB was introduced so that aggrieved parties could take their case to the courts if they were unhappy with the decision of the CLB. *(Clause 20 of the Report of the Joint Committee on the Companies (Amendment) Bill 1974 amending Sections 17, 18, 19, 79, 141 and 186 to the Companies Act 1956)*

- some of the requirement for companies to obtain government approval for transactions were reduced. For example government approval for some share transactions was reduced. *(Clause 24 of the Report of the Joint Committee on the Companies (Amendment) Bill 1974 amending Section 108 to the Companies Act 1956)*

Most of the criticisms were not, however, persuasive and the changes to the Bill at the joint committee stage were not major. The same criticisms were made at the parliamentary debate stage but again no major changes to the Bill were made at this stage either. The Companies (Amendment) Bill 1974 was therefore promulgated with only relatively few changes made during the parliamentary review and debate of the Bill.

As discussed in chapter 4 at this time, there was a general feeling that the corporate sector needed to be controlled strongly and that Government control was the best and most appropriate means of achieving this. The economy was performing poorly and it was perceived that Government control and planning were needed to generate healthy economic growth.

To some extent the economic and social aims of the government were supported by the corporate sector. At the same time, there was some recognition that the corporate sector needed to have some flexibility and that excessive regulations would stifle business initiative and entrepreneurship, although in practice, these concerns were not given the same priority as controlling the corporate sector. These concerns were very much reflected in the provisions of the Companies (Amendment) Bill 1974. *(Chapter 4; Report of the Joint Committee on the Companies*

(Amendment) Bill 1974, pages v to vi, xvii to xxix; Indian Parliamentary debates on Companies (Amendment) Bill 1974 on 2nd, 5th, 19th and 22nd August 1974; financial reports of companies in India, years ending 1964, 1969, 1970 and 1975)

From the above it can be seen that the DCA were very influential in the promulgation of the Companies (Amendment) Bill 1974, both in the process for promulgating the Bill and in increasing Government control over the corporate sector in the Bill.

The DCA were also able to influence the Companies Act 1956 directly since they had powers to issue notifications amending the Companies Act in their own right. The DCA used these powers in 1973 to issue a notification, GSR 494-E which also introduced major changes to the Companies Act and the accounting system. These included the requirement for companies to provide the following disclosures in their annual accounts:

- disclosures of loans to related companies.
- a statement of investments, separately classifying trade investments and other investments to be annexed to the balance sheet.
- disclosures of turnover, giving the value and quantities of sales in respect of each class of goods dealt with by the company.
- disclosures by manufacturing companies of the value and quantities of raw materials consumed.
- disclosures by trading companies of the value and quantities of purchases and of opening and closing stocks, by class of goods.
- disclosures of any miscellaneous item in the profit and loss account exceeding 5,000 rupees
- disclosures by manufacturing companies of detailed quantitative on information on licensed capacity, installed capacity and actual production in respect of finished goods.
- disclosures of the value of imports by the company during the financial year in respect of raw materials, components and spare parts and capital goods.

- disclosures of expenditure in foreign currency during the financial year on account of royalty, know-how, professional and consultation fees, interest and other matters

- disclosures of the value of all imported raw materials, spare parts and components consumed during the financial year and the value of all indigenous raw materials, spare parts and components consumed during the year

- disclosures of the amount remitted during the year in foreign currencies on account of dividends with a specific mention of the number of non-resident shareholders, the number of shares held by them on which dividends were due and the year to which the dividends related

- disclosures of earnings in foreign exchange of export of goods, royalty, know-how, consultation fees, interest and dividend and any other income

(Notification number GSR 494E, Government of India, 1973)

These regulations were issued for the same reasons that initiated the Companies (Amendment) Bill 1974 and again show the importance of the DCA in influencing the Companies Act 1956 and in influencing accounting regulations and the accounting system.

Interactions between the Accounting Profession and accounting regulation in the Companies Act

The accounting profession, including individual accountants, accounting firms and the accounting professional bodies in India were very involved in the promulgation of the Companies (Amendment) Bill 1974. In particular the professional accounting bodies, the Institute of Chartered Accountants of India, (ICAI), the Institute of Cost and Works Accountants of India (ICWAI) and the Institute of Company Secretaries of India (ICSI) all tried to influence the Bill in several ways. All three bodies sent in written submissions to the joint committee and were invited to give oral evidence to the joint committee. As well as the professional accounting bodies, individual accountants and firms of accountants also sent in written submissions to the joint committee and some were invited to give oral evidence to the joint committee too. In addition to these direct representations, the accounting bodies lobbied the DCA and Members of Parliament to present their arguments and act in their interests. *(Report of the Joint Committee on the Companies (Amendment) Bill 1974, pages v to vi, xvii to xxix; Indian*

Parliamentary debates on Companies (Amendment) Bill 1974 on 2nd, 5th, 19th and 22nd August 1974; interviews with senior representatives of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998, 17th November 1998, 18th November 1998 and 20th November 1998)

The interactions of between the three professional accounting bodies, the ICAI, the ICWAI and the ICSI and legal accounting regulation are discussed below.

The Institute of Chartered Accountants of India

The ICAI were very involved in the promulgation of the Companies (Amendment) Bill 1974. In general, the Institute of Chartered Accountants of India (ICAI) and chartered accountants were very much in favour of reducing control and bureaucracy relating to the corporate sector. They were of the view that the Bill was too restrictive and would stifle business initiatives. These concerns were also the concerns of the businesses and companies that the accountants audited and hence both the business community and chartered accountants argued for predominantly the same outcomes. *(interviews with senior representatives of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998, 17th November 1998, 18th November 1998 and 20th November 1998; interviews with senior Government officials on 10th November 1998 and 17th November 1998; Lall R.M., and Mittal S.R., Chartered Accountant, Vol xxii, September, 1973, pages 121 to 124; Gupta S.K., Chartered Accountant, Vol xxii, January 1974 pages 372-379)*

The ICAI, the auditing firms and individual chartered accountants were also particularly concerned about some of the specific provisions contained in the amendment Bill which directly affected their rights to perform audits. These included:

- the introduction of auditor rotation. Auditor rotation had been proposed with a view to bringing about a disassociation of auditors from companies and also to achieve a wider distribution of work among different auditors, particularly young auditors. *(Clause 20 of the Companies (Amendment) Bill 1974 amending section 224 of the Companies Act 1956)*
- introducing a ceiling on the number of audits that any one auditor could undertake. This provision was intended to promote auditor independence and again to achieve a wider distribution of work among different

auditors, particularly young auditors. *(Clause 20 of the Companies (Amendment) Bill 1974 amending section 224 of the Companies Act 1956)*

- introducing a requirement for some companies, as specified by government, to have cost audits performed. These cost audits were to be undertaken by members of the ICWAI and the cost audit reports were to be sent to government. Cost accounting was perceived by government to be important for promoting cost consciousness and efficiency in the corporate sector which would in turn help rapid economic growth. *(Clause 25of the Companies (Amendment) Bill 1974 amending Section 233 of the Companies Act 1956)*

The ICAI and the auditing firms made many representations to the joint committee. They made the second largest number of representations to the joint committee, as shown in appendices 14 and 15. 16% of the written submissions came from the ICAI and individual chartered accountants and 12% of the parties giving oral evidence to the committee were from the ICAI or individual chartered accountants. The interest of the corporate sector too coincided with the interests of the chartered accountants in most cases. 45% of all written submissions received by the joint committee were from the corporate sector and 46% of all parties giving oral evidence to the committee were from the corporate sector. The business community and chartered accountants therefore represented their case very strongly in Parliament, as the Bill directly affected their interests in many ways. *(Report of the Joint Committee on the Companies (Amendment) Bill 1974, pages v to vi, xvii to xxix; Indian Parliamentary debates on Companies (Amendment) Bill 1974 on 2nd, 5th, 19th and 22nd August 1974; interviews with senior representatives of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and, 18th November 1998; interviews with senior accounting personnel in companies on 27th October 1998, 29th October 1997, 2nd November 1998 and 5th November 1998; Lall R.M., and Mittal S.R., Chartered Accountant, Vol xxii, September, 1973, pages 121 to 124; Gupta S.K., Chartered Accountant, Vol xxii, January 1974 pages 372-379)*

The ICAI and the auditing firms made strong submissions against auditor rotation and their arguments included that this would be inefficient and impractical. They also argued that the provisions relating to the ceiling on number of audits would be sufficient to ensure auditor independence. They were not in favour of the restriction on the number of audits that could be performed by auditors but recognised that some regulation was inevitable in the socio-economic climate of the time and accepted that this provision was preferable to

auditor rotation. The corporate sector too was against auditor rotation and, as expected, the interests of the business community and the auditors coincided. *(Report of the Joint Committee on the Companies (Amendment) Bill 1974, pages v to vi, xvii to xxix; Indian Parliamentary debates on Companies (Amendment) Bill 1974 on 2nd, 5th, 19th and 22nd August 1974; Lall R.M., and Mittal S.R., Chartered Accountant, Vol xxii, September, 1973, pages 121 to 124; Gupta S.K., Chartered Accountant, Vol xxii, January 1974 pages 372-379)*

The ICAI and other chartered accountants were also concerned about the role of the cost audit and considered that the opportunities for chartered accountants would be reduced if cost audits could only be performed by cost accountants. In the 1970's there was a problem with lack of employment opportunities for young chartered accountants and it was feared that prohibiting chartered accountants from undertaking cost audits would exacerbate the problem. The ICAI therefore promoted the view that chartered accountants should be able to undertake cost audits and this view was included in the evidence submitted to the joint committee. *(Report of the Joint Committee on the Companies (Amendment) Bill 1974, pages v to vi, xvii to xxix; Indian Parliamentary debates on Companies (Amendment) Bill 1974 on 2nd, 5th, 19th and 22nd August 1974; Lall R.M., and Mittal S.R., Chartered Accountant, Vol xxii, September, 1973, pages 121 to 124; Gupta S.K., Chartered Accountant, Vol xxii, January 1974 pages 372-379; Editorial, Chartered Accountant, Vol xix, September 1970, pages 417-429)*

In response to the representations made by the ICAI and individual chartered accountants and the ICAI, the joint committee:

- deleted the auditor rotation provisions and stated that the ceiling on the number of audits any one firm could undertake would be sufficient for auditor independence. *(Clause 30 of the Report of the Joint Committee on the Companies (Amendment) Bill 1974, amending Clause 23 of the revised Companies (Amendment) Bill 1974 and Section 224 of the Companies Act 1956)*
- did not change the provision on the ceiling on the number of audits that could be undertaken by one auditor and placed a further requirement on companies to obtain a certificate from their auditors stating that their appointment was in accordance with this provision, to help enforce this regulation. *(Clause 30 of the Report of the Joint Committee on the Companies (Amendment) Bill 1974, amending Clause 23 of the revised Companies (Amendment) Bill 1974 and Section 224 of the Companies Act 1956)*
- did not change the cost audit provisions. However they felt that the provision should be phrased in a more positive way. They changed the wording to say that chartered accountants who were suitably qualified

could undertake cost audits until there were enough trained cost accountants in practice. *(Clause 25 of the Report of the Joint Committee on the Companies (Amendment) Bill 1974, amending Clause 22 of the revised Companies (Amendment) Bill 1974 and Section 233 of the Companies Act 1956)*

This was probably the most favourable outcome that the chartered accountants could have hoped for. The ICAI and the auditing firms had managed to have the auditor rotation provisions, which they had been extremely concerned about, deleted from the Bill. In return for this, they accepted the ceiling on the number of audits that any one auditor could undertake, even though they were not in favour of this provision either.

The ICAI also made many representations to the joint committee, the Government and members of parliament, trying to change the provisions in the Companies (Amendment) Bill 1974 so that members of the ICAI would be entitled to undertake cost audits. Some notice was taken of the ICAI's point of view in that the phrasing of the clause was changed to emphasise that members of the ICAI would be entitled to carry out cost audits until there were enough trained cost accountants. Indeed it had been quite clear since the 1960's that government were of the opinion that cost accounts and cost audits were vital for economic development and that this function should be independent of the chartered accountants and hence the ICAI were not successful in changing this provision. *(Report of the Joint Committee on the Companies (Amendment) Bill 1974, pages v to vi, xvii to xxix; Indian Parliamentary debates on Companies (Amendment) Bill 1974 on 2nd, 5th, 19th and 22nd August 1974; Lall R.M., and Mittal S.R., Chartered Accountant, Vol xxii, September, 1973, pages 121 to 124; Gupta S.K., Chartered Accountant, Vol xxii, January 1974 pages 372-379; Editorial, Chartered Accountant, Vol xix, September 1970, pages 417-429)*

The ICAI and the auditing firms did therefore influence the Companies (Amendment) Bill 1974, though not as much as they would have liked to. They made many representations to the joint committee and lobbied members of parliament to argue their case in the parliamentary debates and were successful in deleting the auditor rotation provisions. However they were not successful in altering the provisions on the ceiling on the number of audits or the cost audit provisions.

The Institute of Cost and Works Accountants of India

The Institute of Cost and Works Accountants (ICWAI) and individual cost accountants were relatively happy with the Companies (Amendment) Bill 1974, as the Bill contained provisions specifying that members of the ICWAI could perform cost audits. *(Clause 25 of the Companies (Amendment) Bill 1974 amending Section 233 of the Companies Act 1956)*

The ICWAI and some cost accountants did submit evidence to the committee supporting these provisions, defending their right to perform against chartered accountants, but not in great numbers. 2.3% of the written submissions were from cost accountants and 3.5 % of the parties giving oral evidence to the committee were cost accountants as shown in appendices 14 and 15.

This may have been because the provisions of the Bill and government opinion were firmly in the interests of the cost accountants. The Government considered that cost accounting and cost auditing were important for economic and social development and that cost auditors should be separate from the statutory auditors and hence a little more independent of the corporate sector. Despite arguments made by the ICAI that chartered accountants should be allowed to undertake cost audits, the provisions requiring cost accountants to undertake cost audits remained unchanged. Therefore the ICWAI and the cost accountants felt it unnecessary to send in many representations. It may also have been the case that the ICWAI was a relatively new profession and hence, in 1970's, there were not many cost accountants in practice as compared to chartered accountants. The ones that were in practice were involved in the ICWAI and hence representations were made mainly through the professional body and not individually. *(interviews with senior Government officials on 10th November 1998 and 17th November 1998; interviews with senior representatives of the accounting profession on 17th November 1998; Report of the Joint Committee on the Companies (Amendment) Bill 1974, pages v to vi, xvii to xxix; Indian Parliamentary debates on Companies (Amendment) Bill 1974 on 2nd, 5th, 19th and 22nd August 1974; Lall R.M., and Mittal S.R., Chartered Accountant, Vol xxii, September, 1973, pages 121 to 124; Gupta S.K., Chartered Accountant, Vol xxii, January 1974 pages 372-379; Editorial, Chartered Accountant, Vol xix, September 1970, pages 417-429)*

The ICWAI and cost accountants generally welcomed the provisions in the Companies (Amendment) Bill 1974 which related to cost auditing and hence little activity was seen on the part of the cost accountants in the diffusion phase of the promulgation of Bill.

The Institute of Company Secretaries of India

The Institute of Company Secretaries of India (ICSI) and individual company secretaries were also relatively happy with the Companies (Amendment) Bill 1974. The Bill contained provisions requiring all companies over a certain size to employ a company secretary, who would have to be a member of the ICSI. This gave assured employment opportunities to company secretaries and also increased their recognition and status. (*Clause 30 of the Companies (Amendment) Bill 1974 introducing new section into the Companies Act 1956)*

The ICSI and individual company secretaries gave evidence to the joint committee, both written and oral, supporting the provisions relating to the company secretaries. However these were not in great numbers. 3.1% of the written submissions were from company secretaries and 5.2 % of the parties giving oral evidence to the committee were company secretaries, as shown in appendices 14 and 15.

This may have been because the provisions were in the favour of company secretaries and hence company secretaries did not feel the need to send in many representations to the joint committee. Again, as for cost accountants, it may also have been the case that the ICSI was a new profession and hence there were few company secretaries in practice in the 1970's. Therefore most of the representations came through the ICSI, the professional body for company secretaries.

The provisions relating to company secretaries were also considered important by government. Company secretaries were expected to increase the professional management of companies and improve corporate compliance with the Companies Act. In fact the ICSI had been set up, with the support of the DCA

and the Government, to help the administration of the Companies Act and the provisions in the Companies (Amendment) Bill 1974 strengthened the role of the company secretaries. In addition a new form of employment would also be created by the company secretary requirement and this was an important consideration for the Government.

Some arguments were presented by employee representatives against the introduction of company secretaries which would, in their opinion, introduce an unproductive elite into companies but these arguments were not successful. In addition the ICAI argued that the Companies Bill itself should specify the qualifications of company secretaries and that there was no need for the ICSI to be involved at all. However the Government supported the provisions and the ICSI, to which it had close links. The company secretary provisions were therefore not amended or deleted from the Bill. (*Report of the Joint Committee on the Companies (Amendment) Bill 1974, pages v to vi, xvii to xxix; Indian Parliamentary debates on Companies (Amendment) Bill 1974 on 2nd, 5th, 19th and 22nd August 1974; interviews with senior Government officials on 10th November 1998 and 17th November 1998; interviews with senior representative of the accounting profession on 20th November 1998)*

As outlined above, all three professional accounting bodies were involved in the promulgation of the Companies (Amendment) Bill 1974. The cost accountants and company secretaries were happy with the provisions and hence made relatively few submissions to the joint committee. The chartered accountants, on the other hand, were very concerned about the provisions on

- auditor rotation. *(Clause 20 of the Companies (Amendment) Bill 1974)*
- introducing a ceiling on the number of audits that any one auditor could undertake. *(Clause 20 of the Companies (Amendment) Bill 1974 amending section 224 of the Companies Act 1956)*
- introducing the requirement for cost audits to be performed by members of the ICWAI and cost audit reports to be sent to government. *(Clause 25of the Companies (Amendment) Bill 1974 amending Section 233 of the Companies Act 1956)*

They therefore argued against these in significant numbers. The corporate sector also supported the views of the chartered accountants and hence the chartered

accountants successfully managed to have the auditor rotation provisions removed from the Bill and the cost audit provisions amended slightly. However they were unable to have the provisions on the ceiling on audits and cost audits changed due to the support of these provisions by the Government and the other accounting bodies. The ICAI did influence the Companies (Amendment) Bill 1974 but were, perhaps, not as influential as they had been in the promulgation of the Companies Act 1956, or as influential as they would have liked to be.

Trans system activity

Trans-system activity, activity between the social systems neighbouring the accounting system and the accounting system itself, is also seen in the promulgation of the Companies (Amendment) Bill 1974. Trans-system activity is seen between the social systems most interested in, and affected by accounting. In this change, trans-system activity is seen between the parliamentary system, the corporate sector and employee representatives and legal accounting regulation. Other parties also participate in the process but only in small numbers, for example, shareholder associations, stock exchanges and investment representatives, and therefore do not significantly influence the amendment Bill. Trans-system activity is discussed below.

Interactions between Parliament and accounting regulation in the Companies Act

Accounting is regarded in India as an important tool to encourage economic development and hence government is actively involved in accounting regulation. Accounting is used to try and affect corporate behaviour and encourage parties to act in ways deemed optimal by the government and Parliament, mainly in areas such as economic efficiency, prevention of fraud and control of the corporate sector. Accounting regulation is therefore very much part of the social system and accounting change is motivated by social and economic concerns. These concerns lead to the inclusion of provisions relating to

accounting and financial disclosures in the Companies Act and in amendment Bills to the Companies Act.

Accounting regulation therefore is directly influenced by the Parliament, as accounting is included in legislation, which is promulgated through the normal parliamentary process, as described earlier in the chapter. This direct influence is considered appropriate since accounting has social and economic implications and consequences. It is also recognised that because of these social and economic implications, accounting affects many different parties. The parties affected by accounting are therefore interested in accounting regulation and actively take part in the debates on the Companies Act and amendment Bills. These debates take place within the parliamentary process. All parties have the opportunity to openly make representations if they so wish.

In the promulgation of the Companies (Amendment) Bill 1974, Parliament had the opportunity to influence the provisions of the Bill, including the accounting provisions included in the Bill, during the joint committee review of the Bill and in the parliamentary debates on the Bill. All parties had the opportunity to send in written representations to the joint committee and to give oral evidence to the committee. In addition all parties lobbied members of parliament, both members of parliament who were members of the joint committee and members of parliament who participated in the parliamentary debates on the Bill, to present their point of view. *(Report of the Joint Committee on the Companies (Amendment) Bill 1974, pages v to vi, xvii to xxix; Indian Parliamentary debates on Companies (Amendment) Bill 1974 on 2nd, 5th, 19th and 22nd August 1974; interviews with senior Government officials on 10th November 1998 and 17th November 1998)*

The joint committee did make some changes to the provisions of the Bill for example:

- deleted the auditor rotation provisions. *(Clause 20 of the Report of the joint committee on the Companies (Amendment) Bill 1974)*
- tightened the definition of group and making the definition of "under the same management" wider. *(Clauses 2,4 and 17 of the Report of the Joint Committee on the Companies (Amendment) Bill 1974, amending Clause 2 of the revised Companies (Amendment) Bill 1974 and Sections 18 and 43 of the Companies Act 1956)*

- transferred powers from the government to the CLB and introducing a right of appeal against the decisions of the CLB. *(Clause 20 of the Report of the Joint Committee on the Companies (Amendment) Bill 1974, amending Clauses 5, 9, 13 and 14 of the revised Companies (Amendment) Bill 1974, amending Sections 17, 18, 19, 79, 141 and 186 to the Companies Act 1956)*

- required only large companies to comply with disclosures on contracts in which directors were interested. *Clause 21 of the Report of the Joint Committee on the Companies (Amendment) Bill 1974, amending Clause 6 of the revised Companies (Amendment) Bill 1974 and Section 43 of the Companies Act 1956)*

Some changes were also made to the provisions of the Companies (Amendment) Bill 1974 at the parliamentary debate stage but these changes were only minor changes to the provisions of the Bill.

Thus it can be seen that Parliament did influence and affect the promulgation of the Companies (Amendment) Bill 1974 since the Bill was promulgated through the parliamentary system. Parliament also influenced the accounting regulations since important accounting regulations were included in the Bill.

Interactions between the corporate sector and accounting regulation in the Companies Act

The corporate sector were very much affected by company law and legal accounting regulation. They were probably the party most affected by the Companies (Amendment) Bill 1974 and were therefore very active in the promulgation of this Bill.

The corporate sector sent in many written representations to the joint committee and also gave oral evidence to the joint committee. Individual companies and owners of business did make some representations within the parliamentary process but the most important and influential representations were made through trade associations and chambers of commerce. 45% of the total written submissions made to the joint committee were made by chambers of commerce and trade associations and 10% of the written submissions to the joint committee were from companies and business owners. 46% of the parties giving oral evidence to the committee were chambers of commerce and trade associations

and 2% of the parties giving oral evidence to the committee were companies and business owners, as shown in appendices 14 and 15.

These representations were made to try and reduce the regulations that the corporate sector had to follow and to try to increase the flexibility with which they had to operate. The corporate sector were very much in favour of as little regulation as possible within the regulatory framework which existed and which was, in part, dependent on the social context and culture of the country. In each country a certain amount of regulation will be seen as desirable and acceptable by society as a whole. In addition the methods of regulation will also be determined by society which includes the business community. Indeed, in line with cultural and social context of India and the political ideology in India since independence, the corporate sector also accepted that a certain level of regulation would be imposed. In fact the corporate sector accepted a certain amount of regulation, in line with the culture and social context of the country and perhaps also in return for protection against foreign competition, which increased significantly in the 1970's. *(Chapter 4; Financial reports of Indian companies for the years ended 1965 and 1969)*

In common with the increase in controls over the corporate sector in India at this time, the Companies (Amendment) Bill also included many provisions which increased the controls over the corporate sector. For example:

- the definitions of a "group" and "under the same management" were tightened to try and stop the growth of large groups controlling significant economic resources. *(Clauses 2 and 4 of the Companies (Amendment) Bill 1974 amending Sections 18 and 43 of the Companies Act 1956)*

- private limited companies were to be regarded as public limited companies if 10% of the private limited companies were owned by body corporates. *(Clause 5 of the Companies (Amendment) Bill 1974 amending Section 73 of the Companies Act 1956)*

- restrictions were placed on the acquisition of shares of public companies by individuals and private limited companies and government approval was required for the transfer of some shares. *(Clause 10 of the Companies (Amendment) Bill 1974 amending Section 108 of the Companies Act 1956)*

- a schedule listing important industries where there was strong public interest was introduced. The Bill gave government wide powers to

regulate these public interest industries. *(Clause 41 of the Companies (Amendment) Bill 1974 inserting schedule xiii into the Companies Act 1956)*

- books of account were required to be open to inspection by the registrar or any other officer of government. *(Clause 20 of the Companies (Amendment) Bill 1974 amending Section 209 of the Companies Act 1956)*

- requirements for members of the ICWAI to perform cost audits. *(Clause 25 of the Companies (Amendment) Bill 1974 amending Section 233 of the Companies Act 1956)*

- companies with share capital of more than 25 lakhs were required to employ a company secretary which would help companies be more professionally managed, would improve compliance with the Companies Act and would provide further employment opportunities in the country. *(Clause 30 of the Companies (Amendment) Bill 1974 introducing new section into the Companies Act 1956)*

- central government were given the power, in consultation with the Reserve Bank of India, to prescribe the limits and conditions under which deposits may be invited or accepted by a company from its shareholders or the public. *(Clause 6 of the Companies (Amendment) Bill 1974 introducing new section into the Companies Act 1956)*

- the payment of dividends out of accumulated profits was restricted and dividends were required to be paid out of current year profits. *(Clause 18 of the Companies (Amendment) Bill 1974 introducing new section into the Companies Act 1956)*

- dividend payments had to be transferred to a special bank account within 7 days of the declaration of the dividend. Dividends unpaid after 42 days after declaration had to be transferred to a special account in a scheduled bank and if still unpaid after 3 years, transferred to the central government. *(Clause 16 of the Companies (Amendment) Bill 1974 amending Section 205 of the Companies Act 1956)*

- related party provisions were introduced. The Bill introduced a provision that companies with paid up share capital of more than 25 lakhs rupees, could not enter into contract in which a director of the company was interested without the approval of the central government. *(Clause 28 of the Companies (Amendment) Bill 1974 amending Section 297 of the Companies Act 1956)*

- companies were required to include a statement in the directors' report, showing the name of every employee of the company who was in receipt of more than 36,000 rupees per annum and indicating whether the employee was a relative of any of the directors or managers of the company. *(Clause 22 of the Companies (Amendment) Bill 1974 amending Section 217 of the Companies Act 1956)*

- introducing a provision whereby no partner or relative of any director or manager could earn more than 3,000 rupees from company without the

approval of the members of the company and the government. *(Clause 29 of the Companies (Amendment) Bill 1974 amending Section 314 of the Companies Act 1956)*

Despite some acceptance of the appropriateness of statutory legislation, the corporate sector were, on the whole, against, what they perceived to be, excessive regulation contained in the Companies (Amendment) Bill 1974. They would have preferred to have been able to operate with as little government involvement and control as possible and hence they made representations to this effect. *(Financial reports of Indian companies for the years ended 1965 and 1969; Report of the Joint Committee on the Companies (Amendment) Bill 1974, pages v to vi, xvii to xxix; Indian Parliamentary debates on Companies (Amendment) Bill 1974 on 2nd, 5th, 19th and 22nd August 1974)*

The corporate sector presented their arguments to the joint committee and lobbied members of parliament to present the corporate sector's point of view in the parliamentary debates. These arguments included:

- that the Bill was too bureaucratic and gave too much power and control to the government. This would stifle small businesses and entrepreneurship due to the increased bureaucracy in the system.

- that companies should have more freedom to make their own decisions. The Bill would lead to too much interference in company affairs by government, leading to greater inefficiency in the economy.

- making the definition of "groups" and "under same management" too wide such that unconnected companies would be classed as under the same management

- auditor rotation provisions were onerous and excessive. Auditors provided a valuable service to companies and auditor rotation would lead to an increase in audit inefficiency.

- the regulations against taking deposits from the public and shareholders were too wide and should only apply to public companies.

- the regulations on transfer of dividends to various bank accounts was too onerous and the number of transfers to different bank accounts should be reduced

(Report of the Joint Committee on the Companies (Amendment) Bill 1974, pages v to vi, xvii to xxix; Indian Parliamentary debates on Companies (Amendment) Bill 1974 on 2nd, 5th, 19th and 22nd August 1974; Financial reports of Indian companies for the year ended 1970 and 1975)

These representations did have some influence, for example:

- the definitions of "under the same management" was made less tight. *(Clause 18 of the Report of the Joint Committee on the Companies (Amendment) Bill 1974, amending Clause 4 of the revised Companies (Amendment) Bill 1974 and Sections 43 and 370 of the Companies Act 1956)*

- restrictions on the transfer of shares were reduced. *(Clause 24 of the Report of the Joint Committee on the Companies (Amendment) Bill 1974, amending Clause 12 of the revised Companies (Amendment) Bill 1974 and Section 108 of the Companies Act 1956)*

- the provisions relating to auditor rotation were deleted. *(Clause 20 of the Companies (Amendment) Bill 1974 amending section 224 of the Companies Act 1956)*

- powers were transferred from the government to the CLB and a right of appeal to the high courts against the decisions of the CLB was introduced. *(Clause 20 of the Report of the Joint Committee on the Companies (Amendment) Bill 1974, amending Clauses 5, 9, 13 and 14 of the revised Companies (Amendment) Bill 1974, amending Sections 17, 18, 19, 79, 141 and 186 to the Companies Act 1956)*

- the limit for defining "public limited companies" were changed from 10% ownership by body corporates to 25% ownership by body corporates. *(Clause 21 of the Report of the Joint Committee on the Companies (Amendment) Bill 1974, amending Clause 6 of the revised Companies (Amendment) Bill 1974 and Section 43 of the Companies Act 1956)*

- the provisions on company deposits were reduced for example companies could now accept deposits from directors and shareholders without advertising . *(Clause 22 of the Report of the Joint Committee on the Companies (Amendment) Bill 1974, amending Clause 7 of the revised Companies (Amendment) Bill 1974 introducing new section of the Companies Act 1956)*

- companies would be allowed to transfer unpaid dividends to a special account after 42 days, rather than requiring dividend payments to be transferred to special bank account within 7 days of the declaration of the dividend and then transferred again after 42 days. *(Clause 16 of the Companies (Amendment) Bill 1974 amending Section 205 of the Companies Act 1956)*

- provisions on related parties would apply to only large companies i.e. companies with paid up share capital of more than 1 crore rupees. *(Clause 35 of the Report of the Joint Committee on the Companies (Amendment) Bill 1974, amending Clause 28 of the revised Companies (Amendment) Bill 1974 and Section 297 of the Companies Act 1956)*

Thus the corporate sector were influential in changing the regulations included in the Companies (Amendment) Bill 1974. However, despite the criticisms, most

of the regulations faced by the corporate sector were retained in the Companies (Amendment) Bill 1974. In fact, in some cases, the regulations faced by the corporate sector were increased by the joint committee. For example

- the definition of a "group" was tightened. *(Clauses 2 and 4 of the Companies (Amendment) Bill 1974 amending Sections 18 and 43 of the Companies Act 1956)*

- all large companies, as measured by turnover, were to be regarded as public companies since large companies had a strong public and employee interest. *(Clause 21 of the Report of the Joint Committee on the Companies (Amendment) Bill 1974, amending Clause 6 of the revised Companies (Amendment) Bill 1974 and Section 43 of the Companies Act 1956)*

- a clause requiring companies to transfer a certain % (the committee suggested 10%) of the current profits to reserves was introduced. *(Clause 27 of the Report of the Joint Committee on the Companies (Amendment) Bill 1974, amending Clause 18 of the revised Companies (Amendment) Bill 1974 introducing new section of the Companies Act 1956)*

Thus it can be seen that the corporate sector were able to influence the provisions of the Companies (Amendment) Bill 1974 to some extent and were able to introduce some reduction in the regulations in the Bill. However the Government and the DCA influenced the Bill more than the corporate sector with the Bill that was promulgated including many strong regulations and strong government controls over the corporate sector. This was very much in line with the culture, social context and political ideology of the time.

Interactions between employee representative and accounting regulation in the Companies Act

Employees too were interested in the Companies (Amendment) Bill 1974. The Companies Act including accounting, affects all society and not just accountants and the corporate sector. Because accounting has social and economic consequences, it affects all members of society including employees. India also explicitly wanted to develop economic growth with social justice and this meant dealing with employees in a fair and equitable manner. This meant creating employment opportunities in the country which would help the large population living in poverty. Indeed employee and employment issues were, and still are, important issues in the country. *(Report of the Joint Committee on the Companies*

(Amendment) Bill 1974, pages v to vi, xvii to xxix; Indian Parliamentary debates on Companies (Amendment) Bill 1974 on 2nd, 5th, 19th and 22nd August 1974; Chapter 4)

In addition, there was and still is, a significant representation in Parliament of members of the communist party who fight against capitalism, even the mixed economy seen in India until the 1990,s and who fight strongly for employee rights and issues. The communist party members and other employee representatives, mainly trade unions, made representations to the joint committee, arguing that:

- the Companies Act promoted the interests of business to the detriment of employees and other stakeholders in society.
- corporate regulations ought to be much stronger and tighter and less favourable towards the business community.
- the increased bureaucracy and power in the hands of government and the Company Law Board would lead to a less open, less transparent system and would lead to more corruption in Government and Parliament.
- in relation to accounting, they considered an independent audit function to be important, both for statutory audits and cost audits. They wanted auditor rotation to reduce collusion between accountants and company management at the expense of employees.
- the introduction of company secretaries would create an unnecessary and unproductive elite in society.
- some members of parliament wanted more extreme provisions such as nationalisation of the audit function and nationalisation of key manufacturing industries.

These representations were made on behalf of employees to the joint committee and in the parliamentary debates on the Bill. However this lobby did not have much influence on the regulations despite their vociferous opposition to the Bill. They were certainly much less influential than the DCA, the accounting profession and the corporate sector since most of the provisions that were promulgated were not in line with what the employee representatives wanted.

The Reaction Phase

The system of promulgating regulations in India is such that interested parties try and influence statutory regulation, before it is promulgated. Once the regulations are promulgated and become law, all companies follow them in a very uniform way. Companies do not register any protest against the regulation by not following the regulations. This is very much in line with the culture of the country and is seen in the survey of 1996 accounts and in the survey of accounts from the 1950's and discussed in interviews. *(Chapter 5; interviews with senior Government officials on 10th November 1998 and 17th November 1998; interviews with senior accounting personnel in companies on 27th October 1998 29th October 1997, 2nd November 1998 and 5th November 1998)*

Instead it is expected that lobbying would take place, mainly through the trade associations for the corporate sector and by other parties such as employee representatives and the accounting profession, to try and change the regulations if they are thought to be too onerous or ineffective. Thus the reaction phase is generally not openly seen. The reaction phase does occur but slowly and over a long period of time. Indeed minor changes to the Companies Act took place after 1974 but the next major change to the act did not take place until 1988. This is discussed in the next chapter. *(Report of the Joint Committee on the Companies (Amendment) Bill 1974, pages v to vi, xvii to xxix; Indian Parliamentary debates on Companies (Amendment) Bill 1974 on 2nd, 5th, 19th and 22nd August 1974; interviews with senior Government officials on 10th November 1998 and 17th November 1998)*

The reaction phase comprises of both intra-system activity and trans-system activity as for the diffusion phase of the change but is not visible. It is expected that the same parties who lobbied and tried to influence the Companies Act after the Companies (Amendment) Bill 1974 was promulgated, were the same parties that were involved in the diffusion phase of the promulgation of the Bill i.e. mainly the Government, accounting profession, the corporate sector and employee representatives.

Culture and social context

Culture and social context are seen to be important in all stages of the promulgation of the Companies (Amendment) Bill 1974. Changes to accounting regulations are initiated in the source phase in order to help tackle problems that arise from the socio-economic context of the country. In this case, changes were initiated to try and tackle poor economic performance, economic inefficiency, economic concentration, auditor independence, fraud and related party transactions. Indeed accounting was deemed to have an important role in social development and accountants were encouraged to have social responsibilities, in line with the general socio-economic climate of the time. *(Report of the Joint Committee on the Companies (Amendment) Bill 1974, pages v to vi, xvii to xxix; Indian Parliamentary debates on Companies (Amendment) Bill 1974 on 2nd, 5th, 19th and 22nd August 1974; President's page, Charted Accountant, Vol xix, December 1970, pages 471 to 472; President's page, Charted Accountant, Vol xix, December1970, pages 83-84)*

Culture is also seen to be important in the diffusion and reaction phases of the change. The diffusion phase of the promulgation of the Companies (Amendment) Bill 1974 provides some understanding of the authority for the accounting system. The cultural values in India, as discussed in chapters 4 and 5, indicate that authority for the accounting system in India will come from both statute and professional accounting bodies. The cultural values also indicate that there will be uniformity in the application of accounting regulations. This is indeed what is seen in India. Statutory control is very important in India but there is also a strong accounting profession and both provide the authority for the accounting system. In the diffusion phase of this change, accounting regulation was included in the Companies (Amendment) Bill 1974, which was promulgated through the parliamentary system. There was also active involvement in legal accounting regulation by the accounting profession. In addition, the survey of financial statements of companies in India from 1950 to 1996, shows that the large companies in India do follow accounting regulations in a very uniform way. The Government is also heavily involved in regulating the corporate sector, including the accounting regulations, both in the process of promulgating the Bill and giving increased powers to the Government, both directly and indirectly through the CLB. Finally there is a strong accounting profession in

India which, together with statutory control, gives the authority for the accounting system in India. This is very much in line with what is indicated by the cultural values of India. *(Report of the Joint Committee on the Companies (Amendment) Bill 1974, pages v to vi, xvii to xxix; Indian Parliamentary debates on Companies (Amendment) Bill 1974 on 2nd, 5th, 19th and 22nd August 1974; interviews with senior Government officials on 10th November 1998 and 17th November 1998; Chapter 5)*

Finally, culture is also seen to be important in the reaction phase. The cultural characteristics of India indicate that regulations will be followed in a uniform way. This is seen with little visible reaction to the promulgation of the Companies Bill 1974.

Culture is therefore seen to be an important factor affecting accounting and culture and social context play an important role in accounting and accounting change at all stages of the change.

Politics and accounting change

The promulgation of the Companies (Amendment) Bill 1974, in common with the promulgation of the Companies Act 1956, shows that the process of promulgating legal accounting regulation is surrounded by political processes.

Accounting is political in several different ways. Key accounting regulations have been included in the Companies Act 1956, which was promulgated using the parliamentary system. Changes to accounting regulations included in the Companies Act are incorporated into amendment bills to the Companies Act, which are also promulgated using the parliamentary system. Thus accounting regulations are included in statutory legislation, promulgated through the parliamentary system and hence influenced and affected by Parliament. In this case, Parliament influenced the Companies (Amendment) Bill 1974, at both the joint committee stage and during the parliamentary debates on the Bill.

Accounting is also political with strong Government involvement in accounting. This is seen in the involvement of Government and the DCA in the process for

promulgating the Companies (Amendment) Bill 1974 and by the increased powers given to the Government by the Bill, both directly and through the CLB.

Finally the process of promulgating the Companies (Amendment) Bill 1974 is seen to be surrounded by political negotiations between the main parties interested in accounting. Accounting regulations are seen to be the outcome of interactions between the different parties interested in the Companies Act and in legal accounting regulation. This is done within the full parliamentary process. The most influential party in the change is the Government via the DCA. Members of the DCA drafted the Bill and senior officials of the DCA were key members of the joint committee. These officials were actively consulted about the Government's view on any changes proposed to the Bill.

The accounting profession and the corporate sector were also influential in the process of promulgating the Companies (Amendment) Bill 1974. Both parties sent in written representations to the joint committee, gave oral evidence to the joint committee and lobbied members of parliament actively. These parties did manage to influence the provisions of the Companies (Amendment) Bill to some extent, but were not as influential as the Government and the DCA.

Summary and conclusions

The theoretical framework proposed in chapter 3, can be used to analyse the influences of cultural and political processes on accounting change.

Using the framework, the promulgation of the Companies (Amendment) Bill 1974 can be broken down into source, diffusion and reaction phases. The source of the promulgation of the Companies (Amendment) Bill 1974, comes from outside the accounting system and is the government's concern to improve economic and social development, control economic concentration, improve economic efficiency, control the corporate sector and tackle abuses in the

corporate sector. Accounting is seen as a tool that can help in these aims and, as such, is recognised to be more than a technical procedure.

In the diffusion phase of the change, intra-system activity and trans-system activity are seen. Intra-system activity is seen between the Department of Company Affairs and the accounting profession and legal accounting regulation. Trans-system activity is seen between Parliament, the corporate sector and employee representatives and legal accounting regulation.

The importance of culture and social context is seen in all phases of the accounting change. In the source phase of the change, culture and social context are important since changes to the Companies Act are initiated because of social and economic concerns and hence accounting change arises from outside the accounting system.

Culture and social context are also important in the diffusion phase of the change. Culture and social context affect the institutions involved in accounting change, the methods chosen to regulate accounting and the interactions between the parties interested in accounting change. The Companies Act is chosen as the most appropriate means of regulating the corporate sector including accounting regulation and there is strong government control, both in the process of promulgating the regulations and in the regulations themselves. The culture of India also indicates that the authority for the accounting system will be a mixture of statutory authority and professional authority and this is indeed seen with both statutory accounting regulation important in India along with an active and influential accounting profession.

Finally, the reaction phase to the change is not visible and culture may explain, in part, the lack of visible reaction to the promulgation of the Companies (Amendment) Bill 1974. Companies in India, generally, follow legal accounting regulations in a very uniform way and do not ignore regulations, even if they are unhappy with the regulations.

The process of promulgating the Companies (Amendment) Bill 1974 is also very political. There is strong involvement in accounting regulation by government and Parliament and the 1974 Amendment Bill that is promulgated is the result of interactions, negotiation and debate between the parties interested in the Bill. These interactions take place within the parliamentary process. In this case, the main interactions are between the DCA, the accounting profession, Parliament, the corporate sector and employee representatives and legal accounting regulation. Of these, the most influential appears to be the Government and the DCA. The accounting profession and the corporate sector too are influential but less so than the DCA. Other parties also make submissions in the process and are part of the negotiation process, which leads to the promulgation of the Bill but are less significant for example shareholder associations, stock exchanges and investment representatives. In addition, accounting is seen, not just an objective technique that neutrally portrays company performance, but instead as an important means of economic and social management. As such government and Parliament wish to directly control accounting and do not wish to leave this just to professional accounting bodies.

Chapter 8

The Promulgation of the Companies (Amendment) Act 1988

Introduction

The next major change to the Companies Act 1956 after 1974 was in 1988 with the promulgation of the Companies (Amendment) Bill 1988. The need for amending the Companies Act had been recognised since the late 1970's. As discussed in chapter 4, India faced major problems in 1970's and the 1980's with a stagnant economy, foreign exchange deficits and an oil crisis. One of the measures that was considered to deal with these problems was another revision of the Companies Act 1956. The Government, headed by Moraj Desai, set up an expert committee, the Expert Committee on the Companies and Monopolies and Restrictive Trade Practices (MRTP) Acts to review the Companies Act and to make recommendations for change. The Expert Committee on the Companies and MRTP Acts reported back to the Government in 1978, making many major recommendations on changes to the Companies Act 1956 including changes to the accounting provisions included in the Act. However, due to the re-election of Indira Gandhi in 1980, the report of the expert committee on the Companies and MRTP Acts (1978) was not acted upon. *(Report of the Expert Committee on the Companies and MRTP Act, 1978; Chakravorty D.K, 1994, chapter 3; Chander S., 1992, pages 29 to 31)*

The need for change remained and eventually in 1988, the Companies (Amendment) Bill 1988 was promulgated. The promulgation of this Bill is discussed below.

The process for promulgating the Companies (Amendment) Bill 1988

The promulgation of the Companies (Amendment) Bill 1988 started in 1987 with the drafting of an amendment bill to the Companies Act 1956, by the Department of Company Affairs (DCA). This Bill, the Companies (Amendment) Bill 1987, was then introduced into Parliament by the Government in August 1987 and was promulgated as the Companies (Amendment) Bill 1988 in May 1988. *(Indian Parliamentary debate on Companies (Amendment) Bill 1988, 27th April 1988)*

From August 1987 to January 1988, the DCA which was at this time, under the Ministry of Law, Justice and Company Affairs, obtained comments and representations from companies, chambers of commerce, professional accounting bodies, stock exchanges and other institutions and parties interested in the contents of the draft Companies Bill. *(Indian Parliamentary debate on Companies (Amendment) Bill 1988, 27th April 1988)*

The DCA then amended the draft Bill by tabling official amendments to the Bill after circulating these amendments to all members of parliament. These amendments were not available for inspection. The revised draft Bill was then debated directly in Parliament, three times in the Lok Sabha and three times in the Rajya Sabha.

Some of the main provisions of the Bill were as follows:

- the delegation of many powers of central government and the courts to the Company Law Board (CLB). *(Clauses 4,36, 37, 41 and 43 of the Companies (Amendment) Bill 1988, amending Sections 10, 235, 248 and 250 of the Companies Act 1956)*
- the removal of the requirement for companies to obtain government approval for the appointment of managing directors and directors' remuneration. *(Clauses 46, 47 and 48 of the Companies (Amendment) Bill 1988, amending Sections 266, 310 and 311 of the Companies Act 1956)*
- companies were stopped from issuing irredeemable preference shares or preference shares redeemable after a period of ten years. *(Clauses 12, 14 and 26 of the Companies (Amendment) Bill 1988, amending Section 78 of the Companies Act 1956)*

- the rules for companies accepting deposits were tightened. *(Clauses 7 and 8 of the Companies (Amendment) Bill 1988, amending Sections 43 and 588 of the Companies Act 1956)*

- many specified limits were eliminated and the Government given the power to determine appropriate limits for example for setting the remuneration levels which determined higher paid employees. *(Clauses 30 and 49 of the Companies (Amendment) Bill 1988, amending Sections 217 and 415 of the Companies Act 1956)*
- companies refusing to transfer shares to new members on application were required to give reasons for not doing so and companies issuing new shares had to deliver allotted share certificates to members within three months of allotment. *(Clause 16 of the Companies (Amendment) Bill 1988, amending Section 111 of the Companies Act 1956)*

- companies intending to offer shares or debentures to the public for subscription by the issue of a prospectus had to seek approval for this from a recognised stock exchange. *(Clause 10 of the Companies (Amendment) Bill 1988, amending Section 78 of the Companies Act 1956)*

- company charges had to be registered with the Registrar of Companies. *(Clause 19 of the Companies (Amendment) Bill 1988, amending Section 130 of the Companies Act 1956)*

- companies were allowed to submit shortened annual returns if five correct annual returns had been sent to the Registrar *(Clause 22 of the Companies (Amendment) Bill 1988, amending Section 159 of the Companies Act 1956)*

- companies were allowed to send summary financial statements to their members. *(Clause 31 of the Companies (Amendment) Bill 1988, amending Section 219 of the Companies Act 1956)*

- depreciation was to be calculated in accordance with a new schedule introduced by the Bill rather than calculated in accordance with the Income Tax Act. *(Clauses 1 and 26 of the Companies (Amendment) Bill 1988, amending Sections 66 and 205 of the Companies Act 1956)*

- companies were required to keep all books of account on an accruals basis and according to the double entry system of accounting. *(Clause 29 of the Companies (Amendment) Bill 1988, amending Section 209 of the Companies Act 1956)*

- companies were required to disclose conservation of energy, technology absorption, research and development and foreign exchange earnings and outgo in the directors' report in a prescribed manner. *(Clause 30 of the Companies (Amendment) Bill 1988, amending Section 217 of the Companies Act 1956)*

- provisions on the number of audits that any one auditor could undertake were tightened and extended to cost auditors. *(Clause 35 of the Companies (Amendment) Bill 1988, amending Section 233 of the Companies Act 1956)*

- central Government approval was required for the appointment of cost auditors in public companies. *(Clause 35 of the Companies (Amendment) Bill 1988, amending Section 233 of the Companies Act 1956)*

- company secretaries were required to be members of the Institute of Company Secretaries of India and were given the duty of signing annual returns. "Secretaries in whole time practice" were introduced. *(Clause 2 of the Companies (Amendment) Bill 1988, amending Section 233 of the Companies Act 1956)*

- any officer who was in default of the Companies Act was liable to punishment and the Bill defined what was meant by "officer". *(Clauses 3 and 53 of the Companies (Amendment) Bill 1988, amending Sections 198 and 383 of the Companies Act 1956)*

By the time the Companies (Amendment) Bill 1988 was debated in Parliament, comments from all parties interested in the Bill had been received by the DCA and the draft Bill had already been amended once in light of the comments received. The amendment Bill had been expected for some time and most of the provisions were in line with expectations. Thus, in the parliamentary debates, there was quite a lot of support for the Bill. Many members of parliament argued that the Bill was pragmatic, realistic and would achieve the aims outlined above. There were also some criticisms of the Bill, including that the Bill gave too much power to the government, that the Bill contained excessive regulations for small and medium sized companies and that the Bill did not address many important issues such as employee participation in companies. These arguments are detailed later in the chapter.

Despite these criticisms, only minor changes were made to Companies (Amendment) Bill 1988 in the parliamentary debates on the Bill. The Bill received assent and became law on 24th May 1988. *(Indian Parliamentary debate on Companies (Amendment) Bill 1988, 27th April 1988; Companies (Amendment) Bill 1988)*

Analysis of the promulgation of the Companies (Amendment) Bill 1988

The promulgation of the Companies (Amendment) Bill 1988 can be broken down into three phases, the source phase, the diffusion phase and the reaction phase, using the theoretical framework proposed in chapter 3, as follows.

The Source Phase

The main reasons for promulgating the Companies (Amendment) Bill 1988 were outlined by the Government as follows:

- to liberalise the economy in line with government's general aim of liberalisation, reduce the costs and administrative burden for companies but with retention of some control over the business sector.
- to simplify and streamline the administration of the Companies Act 1956. This included reducing any loopholes in the act and making the provisions of the act more effective.
- to protect the investing public.
- to deal with the issues of economic growth, foreign exchange problems, energy crises and modernisation of the corporate sector, since the corporate sector was seen to be an important part of the national economy.

(Indian Parliamentary debate on Companies (Amendment) Bill 1988, 27th April 1988)

No single intrusive event occurred which led directly to the promulgation of the Companies (Amendment) Bill 1988. Instead there were general government concerns about the need to improve poor economic and social performance and the need to control the corporate sector more effectively. These concerns were also seen in the promulgation of the Companies Act 1956 and its amendment in 1974, as discussed in chapters 6 and 7 and still remained relevant in 1988. In addition in 1988, there was a move away from a heavily controlled and planned economy towards a more liberalised economy. The Government stated that the Companies Act would be revised in light of this move towards liberalisation. *(chapter 6; Chapter 7; Indian Parliamentary debate on Companies (Amendment) Bill 1988, 27th April 1988)*

The source phase of the change took two years to be completed. The actual Bill was started in 1987 and completed in 1988. However the need for a major change to the Companies Act can be traced back to the late 1970's. In 1977 a committee on the Companies and MRTP Acts (commonly referred to as the Sachar committee after its chairman) consisting of experts in corporate affairs, had been set up by the government of the time, to review the Companies Act

1956. The Expert Committee on the Companies and MRTP Acts submitted a very detailed report on company law and accounting in 1978 but this report was not acted upon due to changes in the government in 1980 and in 1985. *(Report of the Expert committee on the Companies and MRTP Acts, 1978;Chakravorty D.K, 1994, chapter 3; Chander S., 1992, pages 29 to 31; Editorial, Chartered Accountant, vol xxvii, February 1979, pages 621 to 622; Majumdar A.K., Chartered Accountant, vol xxvii, January 1979, pages 532 to 550)*

The new government in 1980 wanted to take a fresh look at the Companies Act and they undertook a new examination of company law. This review looked at both current issues in India and international developments in company law, in particular developments in the UK in 1985. Indeed, the review was started by the Indira Gandhi administration and continued by the Rajiv Gandhi administration, which led to some liberalisation of the Companies Act.

The 1988 Bill arose from this review of company affairs but also included some of the recommendations made in the Report of the Expert Committee on the Companies and MRTP Acts 1978 which were still relevant. *(Indian Parliamentary debate on Companies (Amendment) Bill 1988, 27th April 1988; Report of the Expert Committee on the Companies and MRTP Acts, 1978)*

In common with the promulgation of the Companies Act 1956 and the Companies (Amendment) Bill 1974, discussed in chapters 6 and 7, the amendment Bill in 1988 was initiated by government due to their concerns with India's poor economic growth and efficiency. In addition, in the 1970's and 1980's, the government had major problems with foreign exchange and energy shortages to deal with. Furthermore, the government perceived that the corporate sector was underperforming due to old fashioned practices and a lack of research and development and technology absorption. Indeed, this was perceived to be a major contributing factor to the poor economic performance of the corporate sector and the national economy. It was also apparent that, apart from the large companies in India, many companies were still not following the provisions of the Companies Act and that the enforcement of the Companies Act needed to be improved. *(Indian Parliamentary debate on Companies(Amendment) Bill 1988, 27th April 1988; Editorial, Chartered Accountant, vol xxxvi, October 1987, pages 291 to 292; Company*

Law Committee, Chartered Accountant, Vol xxxvi, December 1987, page 593; Report of the Expert Committee on the Companies and MRTP Acts, 1978)

Again as for the previous changes to the Companies Act discussed in chapters 6 and 7, the source of the 1988 change came from outside the accounting system and again the reasons for the change related to wider social and economic issues.

The Diffusion Phase

The Companies (Amendment) Bill 1988 was promulgated to try and deal with the socio-economic problems faced by India in the 1980's as outlined above. The use of statutory regulation, promulgated through the parliamentary system, and regulation by government bodies was also again chosen as the most appropriate means of regulating key areas, as expected with the culture of India.

As for all acts of parliament and parliamentary bills, the Companies (Amendment) Bill 1988 went through the parliamentary process, as outlined below:

- the Companies (Amendment) Bill was proposed by a cabinet minister of the government.
- the DCA drafted the Companies (Amendment) Bill 1988.
- the DCA obtained feedback and representation from all parties interested in the Bill and amended the initial draft of the Bill. In the case of the Companies (Amendment) Bill 1988, this was not an open process. The Bill did not go to any parliamentary committee for discussion and review and therefore the process was shorter than for most other pieces of complex legislation.
- the amended draft Bill was then introduced in Parliament by the government and debated three times in the Lok Sabha and three times in the Rajya Sabha. Final amendments to the Bill were proposed and voted upon.
- after Parliament had amended the draft Bill, it received assent and became law on 24th May 1988.

(Companies (Amendment) Bill 1988; Indian Parliamentary debate on Companies(Amendment) Bill 1988, 27th April 1988)

Both intra-system activity and trans-system activity are seen in the promulgation of the Companies (Amendment) Bill 1988. Intra-system activity is seen mainly between the DCA and legal accounting regulation. The accounting profession in India is also involved in the process for promulgating the Bill but not as actively as for the Companies (Amendment) Bill 1974. Trans-system activity is seen between the parliamentary system and legal accounting regulation and between the corporate sector and legal accounting regulation. Both intra-system activity and trans-system activity are discussed below.

Intra-system activity

Interactions between the Department of Company Affairs and accounting regulation in the Companies Act

The Government, via the Department of Company Affairs (DCA) under the Ministry of Law, Justice and Company Affairs, was involved in the promulgation of the Companies (Amendment) Bill 1988 in all stages of the promulgation of the Bill. The Bill also saw a significant increase in the powers of the Government over the corporate sector.

The DCA was responsible for drafting the initial legislation that was proposed in Parliament. The DCA then obtained feedback and representations on the draft Bill from the public and all parties interested in the legislation and amended the draft Bill, in light of the feedback received, before it was debated in Parliament. These amendments to the Bill were circulated to all members of parliament who could comment on the amendments if they wished but no formal review of the Bill by Parliament was undertaken. These amendments were not available for review.

There were some calls for the Companies (Amendment) Bill 1988 to be referred to a select or a joint parliamentary committee at the start of the debate on the

Bill. These calls were not accepted. Instead it was argued that since there had been an extensive debate on the Bill outside Parliament and representations from parties interested in the Bill had already been obtained by the DCA, there was no need for another review by a committee of Parliament. Despite arguments that public and press debate cannot make up for parliamentary review, no such review took place. *(Indian Parliamentary debate on Companies (Amendment) Bill 1988, 27th April 1988)*

As well as influencing the process for promulgating the Companies (Amendment) Bill, the DCA included many provisions in the Bill which increased government powers over the corporate sector. Indeed, many of the provisions of the Companies (Amendment) Bill 1988 increased the powers of the Government or were provisions which the Government felt were important for the development of the economy or for the protection of shareholders. For example the provisions increasing the powers of the Government included:

- the delegation of many powers of central government and the courts to the CLB, including:

  - the power to place extra conditions on companies such as requiring companies to repay deposits, within specified time periods, if the deposits had not been accepted in accordance with the Companies Act *(Clause 8 of the Companies (Amendment) Bill 1998 amending Section 58 of the Companies Act 1956)*

  - the power to decide whether companies could deviate from some of the requirements of the Bill, such as increasing the time period for share transfers. *(Clause 17 of the Companies (Amendment) Bill 1998 amending Section 113 of the Companies Act 1956)*

  - the power to order investigations of companies. *(Clauses 4, 36, 37, 41 and 43 of the Companies (Amendment) Bill 1998 amending Sections 10, 235, 236, 248 and 250 of the Companies Act 1956)*

  This increased the indirect control of Government over the corporate sector significantly. *(Clauses 4,36, 37, 41 and 43 of the Companies (Amendment) Bill 1988, amending Sections 10, 235, 248 and 250 of the Companies Act 1956)*

- the board of directors of public companies were required to obtain approval by central government before appointing cost auditors *(Clause 35 of the Companies (Amendment) Bill 1988 amending Section 233 of the Companies Act 1956)*

- many limits were eliminated and the Government given the power to determine appropriate limits for example for setting the remuneration levels which determined higher paid employees. *(Clauses 30 and 49 of the Companies (Amendment) Bill 1988, amending Sections 217 and 415 of the Companies Act 1956)*

The provisions protecting shareholders and deposit makers included

- stopping companies from issuing irredeemable preference shares or preference shares redeemable after a period of ten years. *(Clauses 12, 14 and 26 of the Companies (Amendment) Bill 1988, amending Section 78 of the Companies Act 1956)*

- tightening the rules for companies accepting deposits. *(Clauses 7 and 8 of the Companies (Amendment) Bill 1988, amending Sections 43 and 588 of the Companies Act 1956)*

- requiring companies refusing to transfer shares to new members on application to give reasons for not doing so and requiring companies issuing new shares to deliver allotted share certificates to members within three months of allotment. *(Clause 16 of the Companies (Amendment) Bill 1988, amending Section 111 of the Companies Act 1956)*

- company charges were required to be registered with the Registrar of Companies and would not be recognised until this was done. *(Clause 19 of the Companies (amendment) Bill 1988 amending Section 130 of the Companies Act 1956)*

The provisions encouraging companies to focus on areas deemed important by Government for national economic development included:

- requiring companies to disclose conservation of energy, technology absorption, research and development and foreign exchange earnings and outgo in the directors report in a prescribed manner. *(Clause 30 of the Companies (Amendment) Bill 1988, amending Section 217 of the Companies Act 1956)*

- requiring companies to use depreciation rates specified in the Companies Act, rather than rates in the Income tax Act. *(Clauses 1 and 26 of the Companies (Amendment) Bill 1988, amending Sections 66 and 205 of the Companies Act 1956)*

Thus the DCA, a major regulatory body in the accounting system in India influenced the amendment to the Companies Act very significantly, perhaps more than they influenced the Companies (Amendment) Bill 1974, since there was no parliamentary committee review of the Bill. The DCA drafted the initial Bill and thus influenced what would be included in the Bill and what would be discussed and debated by Parliament. The DCA also obtained feedback from all

parties interested in the Bill and tabled amendments to the Bill before it was debated in Parliament. Indeed in some ways the DCA bypassed part of the parliamentary process for promulgating legislation. There was support for some of these provisions in the parliamentary debates on the Bill. For example

- there was support for the delegation of extra powers to the CLB which would take on many of the powers of the courts and give relief to the courts. This would allow a more speedy response to the administration of the act.

- shareholders would be given protection with provisions relating to irredeemable preference shares allowing these shareholders to get their money out of companies, forcing companies to issue share certificates more quickly and forcing companies to give reasons if they refused to transfer shares to new members.

- disclosures of conservation of energy, technology absorption, research and development and foreign exchange which were in the public interest and would encourage companies to focus on these areas by increasing the visibility of these areas.

- reducing the costs for companies for example by allowing summary financial statements to be issued and allowing companies to file shortened annual returns which would also allow them to operate more efficiently

(Indian Parliamentary debate on Companies (Amendment) Bill 1988, 27th April 1988)

However, there were also some criticisms of these provisions, which included:

- that the Government and the CLB were too powerful and this power might be abused by government officials

- small and medium sector enterprises were having to follow excessive regulations. In particular the technical information on conservation of energy, technology absorption, research and development and foreign exchange was argued to be too onerous and not relevant to most small businesses. This would burden small business with costs from which they did not benefit.

- the Bill contained many provisions which gave protection to depositors and shareholders but there was no protection for employees who had as big, if not a bigger stake, in companies.

(Indian Parliamentary debate on Companies (Amendment) Bill 1988, 27th April 1988)

Despite these criticisms, the provisions were not changed and hence the DCA were very important in influencing the Companies (Amendment) Bill 1988. The DCA were particularly important in this change since the Bill did not go through the full parliamentary process and in particular did not go through the committee stage of the parliamentary process.

Instead representations were made directly to the DCA. Information on the representations made to the DCA is not publicly available. However, there is some discussion in the parliamentary debates as to the main parties making submissions to the DCA and these parties are identified as companies, chambers of commerce, professional accounting bodies, professional law bodies, employee representatives, stock exchanges and shareholder associations. It is suggested that these parties would also be lobbying the members of parliament to put forward their point of view in the parliamentary debates, although this is not visible and hence cannot easily be analysed. *(Indian Parliamentary debate on Companies (Amendment) Bill 1988, 27th April 1988; interviews with government officials on 10th and 17th November 1998; Chakravorty D.K., 1994, chapter 2)*

Interactions between the Accounting Profession and accounting regulation in the Companies Act

All three accounting bodies in India , the Institute of Chartered Accountants of India (ICAI), the Institute of Cost and Works Accountants of India (ICWAI) and the Institute of Company Secretaries of India (ICSI) were involved in the promulgation of the 1988 amendment Bill to the Companies Act 1956. They all made representations to the DCA on the draft Bill that was proposed in parliament in August 1987 and would have lobbied members of parliament on the provisions of the draft bill. *(interviews with government officials on 10th and 17th November 1998; interviews with senior accounting personnel in companies on 27th October 1998 29th October 1997, 2nd November 1998 and 5th November 1998)*

However, the Bill did not contain any major regulations affecting the professional accountants. Provisions relating to the statutory audit, the cost audit and company secretaries were only amended very slightly. For example

- company secretaries were now defined to be members of the ICSI, company secretaries were required to sign annual returns and "secretaries in whole time practice" were introduced *(Clause 2 of the Companies (Amendment) Bill 1988 amending Section 233 of the Companies Act 1956)*

- the provisions on the number of audits any one auditor could undertake were tightened with only full time partners being allowed to undertake audits. Audit firms had started to employ part time partners to increase the number of audits they could undertake and this loophole was stopped by this Bill *(Clause 33 of the Companies (Amendment) Bill 1988 amending Section 224 of the Companies Act 1956)*

- the ceiling on the number of audits performed by one auditor was extended to cost auditors and cost auditors were required to certify that they complied with this ceiling *(Clause 35 of the Companies (Amendment) Bill 1988 amending Section 233 of the Companies Act 1956)*

- the board of directors of public companies were required to obtain government approval before appointing cost auditors *(Clause 35 of the Companies (Amendment) Bill 1988 amending Section 233 of the Companies Act 1956)*

Some of these provisions could be regarded as part of the reaction phase to the Companies (Amendment) Act 1974 which had introduced the company secretary and cost audit provisions. The Companies (Amendment) Bill 1988 clarified the provisions and tightened the regulations in relation to how these provisions had been applied in practice.

Other accounting provisions included in the Bill also did not affect the interests of the accounting profession, although they did affect the corporate sector. These included:

- disclosures of conservation of energy, technology absorption, research and development and foreign exchange earnings and outgo. *(Clause 29 of the Companies (Amendment) Bill 1988 amending Section 209 of the Companies Act 1956)*

- all books of account were required to be kept on an accruals basis and according to the double entry system of accounting. *(Clause 29 of the Companies (Amendment) Bill 1988 amending Section 209 of the Companies Act 1956)*

- depreciation rates and policies that companies were required to use were detailed. *(Clauses 1 and 26 of the Companies (Amendment) Bill 1988 amending Sections 66 and 205 of the Companies Act 1956)*

The interests of the accountants were not, however, affected in a major way by the Companies (Amendment) Bill 1988 and hence there is little activity on the part of the accountants. This is borne out in the parliamentary debates with little adverse comment being made on the audit provisions and little comment on the accounting profession and its interests. *(Indian Parliamentary debate on Companies (Amendment) Bill 1988, 27th April 1988)*

Trans system activity

Trans-system activity is also seen in the promulgation of the Companies (Amendment) Bill 1988. Again, in common with the promulgation of the Companies Act 1956 and the Companies (Amendment) Bill 1974, discussed in chapters 6 and 7, trans-system activity is seen between social systems neighbouring the accounting systems and the accounting system itself. The most important trans-system activity is seen between Parliament and legal accounting regulation and the corporate sector and legal accounting regulation. These are discussed below.

Interactions between Parliament and accounting regulation in the Companies Act

Once again, accounting is seen in India as an important tool to encourage economic development and hence Parliament and Government is actively involved in accounting regulation. Accounting is used to try and affect corporate behaviour and encourage parties to act in ways deemed optimal by the Government and Parliament mainly in the areas of economic growth and efficiency. Accounting regulation is seen to be very much part of the social system and accounting change is motivated by social and economic concerns rather than concerns about the technical nature of accounting. Accounting regulation is therefore directly influenced by the Parliament, as accounting is included in the Companies Act and in amendment bills which go through the normal parliamentary process. This direct influence is considered appropriate since accounting has social and economic implications and consequences and hence affects many different parties. *(Indian Parliamentary debate on Companies*

(Amendment) Bill 1988, 27th April 1988; interviews with government officials on 10th and 17th November 1998; interview with senior academic on 28th September 1998; Editorial, Chartered Accountant, vol xxxvi, October 1987, pages 291 to 292; Company Law Committee, Chartered Accountant, Vol xxxvi, December 1987, page 593; Financial reports of Indian companies from 1950 to 1996)

In the case of the Companies (Amendment) Bill 1988, Parliament had the opportunity to influence the Bill only during the parliamentary debates since the Bill was not reviewed by any committee of either of the Houses of Parliament. However, Parliament did not make any major changes to the Companies (Amendment) Bill 1988. This might have been due to the fact that there had been extensive debate on most of the provisions included in the Bill before the Bill got to the parliamentary debate stage and hence most of the provisions were expected by most members of parliament.

The debate on the 1988 amendment Bill was not as open as the 1974 amendment Bill since the 1988 Bill did not go through the parliamentary committee stage. However, from a review of the parliamentary debates, it is clear that the party most affected by the provisions of the amendment Bill is the corporate sector as discussed below.

Interactions between the corporate sector and accounting regulation in the Companies Act

As well as trans-system activity between legal accounting regulation and the parliamentary system, trans-system activity is also seen between the corporate sector and legal accounting regulation. The corporate sector were very much affected by the Companies (Amendment) Bill 1988 including accounting regulation in the Bill. Companies therefore tried to influence the Bill, including its accounting requirements while the Bill was being promulgated. This was done in two ways. Firstly by making representations to the DCA on the draft Bill and secondly by lobbying members of parliament to present the corporate sector's view in the parliamentary debates on the Bill. These representations were undertaken both by companies themselves and through chambers of commerce and trade associations representing the corporate sector such as Confederation of

India Industry, Federation of Indian Chambers of Commerce and Associate Chambers of Commerce of India. The arguments included in the representations made by the corporate sector have been given earlier in the chapter under intra-system activity. *(Indian Parliamentary debate on Companies (Amendment) Bill 1988, 27th April 1988; interviews with senior government officials on 10th and 17th November 1998; interview with senior academic on 28th September 1998; interviews with senior accounting personnel in companies on 27th October 1998 29th October 1997, 2nd November 1998 and 5th November 1998)*

The representations made by the corporate sector were made to try and reduce the regulations that the corporate sector had to follow. Arguments were also made in the parliamentary debates that regulations should be reduced, in line with government's aim of liberalisation, to allow companies to manage themselves as far as practicable. Some liberalisation was seen. For example

- government approval of company transactions relating to the appointment of managing directors and managerial remuneration was reduced *(Clauses 46, 47 and 48 of the Companies (Amendment) Bill 1988 amending Sections 266, 310 and 311 of Companies Act 1956)*
- companies were given the right to submit shortened annual returns *(Clause 22 of the Companies (Amendment) Bill 1988 amending Section 159 of Companies Act 1956)*
- companies were given the right to send summary financial statements to members under specified circumstances *(Clause 31 of the Companies (Amendment) Bill 1988 amending Section 219 of Companies Act 1956)*

In addition some flexibility was introduced into some of the provisions of the Companies (Amendment) Bill 1988 at the parliamentary debate stage, in response to the arguments of the corporate sector.

- a right of appeal to the high court against the decisions of the CLB was introduced. *Clauses 4, 36, 37, 41, 43 of the Companies (amendment) Bill 1988 amending Sections 10E, 10F, 235, 236, 248, 250 of the Companies Act 1956*
- clarification that private limited companies would not become public companies of they accepted deposits from relatives and members was made. *(Clause 7 of the Companies (amendment) bill 1988 amending Section 43A of the Companies Act 1956)*
- the time period for the redemption of irredeemable preference shares was increased from five years to ten years. *(Clauses 13, 14, and 26 of the Companies (amendment) bill 1988 amending Sections 80, 80A and 205 of the Companies Act 1956)*

- the time period within which companies refusing to transfer shares to a member on application was increased from two to three months. *(Clause 16 of the Companies (amendment) bill 1988 amending Section 111 of the Companies Act 1956)*

All of these were very much in line with the wishes of the corporate sector, and indicative of the moves towards liberalisation introduced by the Rajiv Gandhi administration.

However, despite some reduction in the regulations faced by the corporate sector, the corporate sector was not able to persuade the Government or Parliament to reduce the regulations in the Companies Act 1956 significantly. The Companies (Amendment) Bill 1988 included many provisions giving strong government involvement in corporate affairs and these were not changed. These regulation are detailed above, under intra-system activity.

As can be seen from above, there was some movement towards reducing the regulations that the corporate sector had to follow in line with the stated aims of liberalisation by the government. However the government still retained control over the corporate sector as is expected from the cultural characteristics of India. The corporate sector had some limited success in reducing the regulations in the Companies (Amendment) Bill 1988 but the Government via the DCA were more influential in retaining control, despite the Government's stated aim of moving towards liberalisation.

Other trans-system activity

Some other trans-system activity is seen in the promulgation of the Companies (Amendment) Bill 1988 as indicated by the arguments made against the Bill. These included:

- that the Bill contained many provisions which gave protection to depositors and shareholders but there was no protection for employees.
- that some major problems such as collection of excise and tax from companies and how to deal with sick companies were not tackled by the Bill at all.
- that the aims of the Expert Committee on the Companies and MRTP Acts (workers' participation in the management of companies, increasing the professional management of companies, making managerial remuneration commensurate with corporate responsibility and introducing special provisions for the small and medium enterprises and government companies) had not been addressed

(Report of the Expert committee on the Companies and MRTP Acts, 1978; Indian Parliamentary debate on Companies(Amendment) Bill 1988, 27th April 1988)

Indeed, most of the arguments related to the lack of employee protection, participation and representation in corporate affairs although the argument was made less vociferously than in the promulgation of the Companies (Amendment) Bill 1974. The arguments in support of employee participation were not persuasive and the Companies (Amendment) Bill was not changed to include more rights for employees.

The Reaction Phase

As also seen in the Companies (Amendment) Bill 1974, discussed in chapter 7, the system of promulgating regulations in India is such that interested parties try and influence statutory regulation, before it is promulgated. Once the regulations are promulgated and become law, the large companies follow them in a very uniform way. Large companies do not usually register any protest against the regulations by not following the regulations. This is very much in line with the

culture of the country. *(Indian Parliamentary debate on Companies(Amendment) Bill 1988, 27th April 1988; interviews with senior government officials on 10th and 17th November; interviews with senior accounting personnel in companies on 27th October 1998 29th October 1997, 2nd November 1998 and 5th November 1998; financial reports of Indian companies from 1950 to 1996)*

In the promulgation of the Companies (Amendment) Bill 1988, parties interested in the Bill tried to influence the Bill before it was promulgated. Parties such as the government, the accounting profession, employee representatives and the corporate sector made representations to the DCA and lobbied members of parliament to present their point of view in the parliamentary debates. However once the Companies (Amendment) Bill 1988 was promulgated, the large companies complied with the provisions of the Bill in a uniform manner. In the survey of company accounts, all companies studied gave the information required by the Bill with one or two giving the information in advance of the Bill being promulgated. *(Indian Parliamentary debate on Companies(Amendment) Bill 1988, 27th April 1988; interviews with senior government officials on 10th and 17th November; interviews with senior accounting personnel in companies on 27th October 1998 29th October 1997, 2nd November 1998 and 5th November 1998; financial reports of Indian companies from 1950 to 1996)*

The reaction phase is not visible and hence is hard to analyse. However the reaction phase did take place slowly and over a long period of time, although it was not openly seen. It is expected that lobbying would have taken place, mainly through the trade associations for the corporate sector and by other parties such as employee representatives and the accounting profession, to try and change the regulations which they thought were too onerous or ineffective. This would have been through meetings between the parties interested in the Bill and the appropriate officials and bodies such as the DCA and members of parliament. This is indicated in the interviews but cannot easily be identified. *(interviews with senior government officials on 10th and 17th November; interviews with senior accounting personnel in companies on 27th October 1998 29th October 1997, 2nd November 1998 and 5th November 1998; interview with senior Indian academic on 1st September 1998; Interviews with senior accounting personnel in companies on27th October 1998, 29th October 1998, 2nd November 1998 and 5th November 1998)*

In fact, some of the provisions of the 1988 Amendment Bill itself can be seen, in part, as the culmination of the reaction phase of the 1974 Bill. Changes were made, in response to the lobbying that had taken place on the Companies (Amendment) Bill 1974, to make some of the provisions more effective. For example the clarification of the statutory audit provisions, cost audit provisions and the company secretary provisions could be seen as the end of the reaction phase to the Companies (Amendment) Act 1974 in which these provisions were first included. *(Clauses 2, 33 and 35 of the Companies (Amendment) Bill 1988 amending Sections 233 and 224 of the Companies Act 1956)*

Culture and social context

Culture and social context, as outlined in chapters 4 and 5, are important in all three stages of the promulgation of the Companies (Amendment) Bill, 1988. Changes to accounting regulation are initiated for socio-economic reasons. In this case, changes were initiated to try and tackle poor economic performance, foreign exchange problems, an energy crisis in the country and the lack of use of modern technology by Indian companies. In addition, liberalisation of some of the regulations is also, for the first time, seen , due to changes in the Government in 1985.

Culture is also seen in the diffusion and reaction phases of the change. In the diffusion phase of the change, culture influences the processes and institutions used to promulgate the regulatory changes. As indicated by the cultural characteristics of India, statutory control and government control are expected to be important means of regulation in India and affect all social systems in India. Accounting too is expected to be affected by strong statutory control, control by Parliament and regulation by government institutions. In India, the Companies Act, promulgated through the parliamentary system, is chosen as the most appropriate means for promulgating accounting change in 1988, which is very much in line with the culture of India.

In addition, strong government control is seen in the change. There is strong involvement by the DCA in the process for promulgating the Bill as well as the Bill containing regulations which give the Government strong control of the corporate sector.

Finally, culture is also seen to be important in the reaction phase. The cultural characteristics of India indicate that regulations will be followed in a uniform way, at least by the large listed companies and this is indeed what is seen in the survey of the financial reports of the large listed companies in India accounts. There is no visible reaction to the promulgation of the Companies (Amendment) Bill 1988 and this may also be explained by the cultural context of India, as for the promulgation of the Companies (Amendment) Bill 1974. *(Financial Reports of Indian companies from 1950 to 1996)*

Although the reaction phase is not visible, it does occur and it is expected that the parties affected by the legislation make representations to the DCA and members of Parliament. It is expected that the same parties who tried to influence the Companies (Amendment) Bill 1988 itself are the same parties that make representations after the Bill is promulgated i.e. mainly the corporate sector, the accounting profession and employee representatives. *(interviews with senior government officials on 10th and 17th November; interviews with senior accounting personnel in companies on 27th October 1998 29th October 1997, 2nd November 1998 and 5th November 1998)*

As discussed above, culture is seen to be an important factor affecting accounting with culture and social context playing an important role in accounting and accounting change at all stages of the accounting change.

Politics and accounting change

The promulgation of the Companies (Amendment) Bill also again shows that the process of promulgating legal accounting regulation is very political.

Once again, accounting is seen to be political with both Parliament and the Government being significantly involved in accounting mattes and accounting change. Major accounting regulations have always been included in the Companies Act, even before independence. The Companies Act and amendments to the Companies Act have always been promulgated through the parliamentary system and hence have been influenced and affected by Parliament. In this case, Parliament had the opportunity to influence the Companies Bill 1988, though was perhaps less influential than in some of the other changes to the Companies Act, since the process for promulgating the Bill was shortened. There was, however, still plenty of opportunity for Parliament to influence the Bill in the parliamentary debates on the Bill. In fact only minor changes were made to the Companies (Amendment) Bill 1988 by Parliament, possibly due to the extensive debate on the Bill before it reached the parliamentary debate stage.

There is also strong Government involvement in accounting. This is seen in two ways in the promulgation of the Companies (Amendment) Bill 1988. Firstly the Government via the DCA was very influential in the process of promulgating the Companies (Amendment) Bill 1988. Secondly there were many provisions in the Companies (Amendment) Bill 1988 which gave the Government increased controls over the corporate sector including the accounting regulations that they were required to follow. Some of this control was direct control but most of the control was indirect through the CLB, a statutory body set up under the DCA to administer and enforce the Companies Act 1956. Government control was, in fact, not significantly reduced, despite attempts to liberalise the economy in the late 1980's

Finally, the process of promulgating accounting regulations is, again, seen to be the result of representations made by all the different parties interested in the Companies Act and in accounting regulation. These representation are made within the parliamentary debates on the Companies (Amendment) Bill 1988 and in meetings between the main parties interested in accounting and the DCA. The most influential party in the change is the Government via the DCA. The DCA drafted the Bill which was introduced into Parliament. After this the DCA

obtained feedback on the Bill and obtained representations from the various parties interested in the Bill. In response to the representations received, the DCA tabled amendments to the Bill before it was debated in Parliament. This, to some extent, replaced the parliamentary review of the Bill, and made the DCA very influential in the promulgation of the Bill. The corporate sector and accounting profession were also involved in the promulgation of the Companies (Amendment) Bill 1988 but were much less important and influential than the DCA.

Summary and conclusions

The analysis of the promulgation of the Companies (Amendment) Bill 1988 reinforces some of the conclusions which were reached in the analysis of the promulgation of the Companies Act 1956 and the Companies (Amendment) Bill 1974.

It can again be seen that the proposed framework does help in analysing accounting change and facilitates the study of cultural and political processes on accounting which are important in determining the outcome of any change.

Accounting changes can be split into source and diffusion phases. The source of the change comes from outside the accounting system and both intra-system activity and trans-system activity are seen in the diffusion stage of the promulgation of the regulation. Intra-system activity is seen in the interactions between the DCA and legal accounting regulation in this change and, to a lesser extent, between the accounting profession and the legal accounting regulation. Trans-system activity is seen between accounting regulation and the parliamentary process and between the corporate sector and accounting regulation.

Culture and social context are important in all phases of the change, dictating what issues will be addressed and determining the processes which will be used to deal with the issues. The promulgation of the Companies (Amendment) Bill

1988 shows that the source of the change comes from outside the accounting system and relates to wider social and economic concerns. In this case these related to economic and social development, foreign exchange deficits, the use of old technology by companies and energy crises.

In addition, accounting in India is recognised by the Government as important for helping economic development and has economic and social consequences. As such accounting regulation is included by government in the Companies Act and is used by government to try and influence corporate behaviour for example in the areas of economic development and conservation of energy.
Culture and social context are also important in the diffusion and reaction phases of the promulgation of the Companies (Amendment) Bill 1988. Culture and social context determine the processes and institutions within which accounting change takes place. In India, the Companies Act is chosen as the best way of regulating the corporate sector including accounting regulation. The legislation is promulgated through the parliamentary system with strong involvement shown by the government, both in the process of change and in the provisions of the Companies (Amendment) Bill itself. This is expected in a country with the cultural characteristic of India. Indeed, the process of promulgating the Companies Bill and the increased Government controls over the corporate sector shows the importance of Government involvement in regulating the corporate sector, including accounting regulations, despite the government's stated aim of moving towards a less planned and more liberalised economy.

Culture and social context is also important in the reaction phase of the change. In line with the cultural characteristics of India, no visible reaction to the Companies (Amendment) Bill 1988 is seen. The cultural characteristics of India, indicate that regulations, especially statutory regulation promulgated by the Government and by Parliament, will be followed in a very uniform way and large companies will not disregard regulations even if they are unhappy with them. This is very much what is seen in the financial reports of large companies in relation to the 1988 amendment bill to the Companies Act 1956.

The process of promulgating the Companies (Amendment) Bill 1988 is also again seen to be very political. There is direct involvement in accounting regulation by government and Parliament and the amendment Bill that is promulgated is the result of interactions between all parties interested in the Bill. The accounting regulations are promulgated by Parliament and are debated within the parliamentary process albeit a shortened parliamentary process. Due to this shortened process, the DCA is more influential in this change than in the promulgation of the Companies (Amendment) Bill 1974. The other main interested parties are the corporate sector (companies, chambers of commerce and trade associations), the accounting profession, employee representatives, stock exchanges and shareholder associations. Of these, the most active is the corporate sector through chambers of commerce, as they are the most affected by the provisions of the Companies Act. In the promulgation of the Companies (Amendment) Bill 1988 change the professional accounting bodies and, employee representatives are much less active and influential than in the 1974 change.

Chapter 9

The Companies Bill 1997

Introduction

Attempts were made to amend the Companies Act 1956 in the 1990's, after the liberalisation of the economy which started in 1991. In 1993, a Companies bill 1993 was proposed. However, this Bill was criticised by almost all the parties interested in the Companies Act including the corporate sector, the accounting profession, banks, financial institutions and capital markets. The main criticism of the 1993 Bill was that it did not address any of the major issues affecting the corporate sector who, for the first time, were having to function in a rapidly changing economic environment. Apart from deleting the managing agency provisions, which were obsolete, the Bill made only minor changes to most of provisions of the Companies Act 1956. The Bill would not have led to a major change in the overall regulations which companies had to follow and was therefore withdrawn. *(Report of the Working Group on the Companies Act, 1956, 1997, page 1)*

After this, in July 1996, the Finance Minister announced the setting up of a Working Group which would re-write the Companies Act and present the rewritten Act as a Bill for debate in 1997. The attempt to promulgate this bill, the Companies bill 1997, is discussed below.

The attempt to promulgate the Companies bill 1997

The Finance Minister of the Government, Mr P Chidambaram, constituted the Working Group on the Companies Act 1956 in August 1996. The Working Group consisted of eight members, representing the accounting profession, the corporate sector, the Government and the legal profession. The members of the Working Group are given in appendix 16. The group had no chairman. Instead

the Government representative, the Secretary of the Department of Company Affairs was designated as the convenor of the group. *(Report of the Working Group on the Companies Act, 1956, 1997, pages 2 to 3)*

The main objectives of the Working Group were to rewrite the Companies Act 1956 to facilitate the growth of the corporate sector under a liberalised, fast changing and highly competitive environment.

Growth and flexibility in the corporate sector were to be encouraged through

- introducing a more appropriate classification of companies, with different levels of control.
- expediting mergers and acquisitions.
- removing barriers to create economies of scale and scope.
- allowing for the greater flow of inter-corporate bonds and investments.

(Report of the Working Group on the Companies Act, 1956, 1997, pages 2 to 3)

However, the Working Group also sought to achieve a balance between this greater flexibility in the corporate sector, in line with international trends, with better disclosures, more efficient enforcement of the Act and tougher penalties for non-compliance with the Act. *(Report of the Working Group on the Companies Act, 1956, 1997, pages 2 to 3)*

The Working Group held thirty-four meetings during which they drafted the Companies Bill 1997, which was a complete rewrite of the Companies Act 1956. In the course of its meetings, the Working Group interacted with all the parties interested in the revision of the Companies Act. The parties with which the Working Group interacted are given in appendix 17. *(Chidambaram P., Statement of Objects and Reasons, 1997; Report of the Working Group on the Companies Act, 1956, 1997, pages 2 to 3)*

The Bill regrouped some of the provisions of the Companies Act, deleted redundant provisions, streamlined some provisions and introduced new provisions in the areas of:

- incorporation and classification of companies
- raising of capital by companies
- internal management of companies and non-financial disclosures to shareholders
- accounting, auditing and financial disclosures
- corporate restructuring of viable companies
- winding up of non-viable companies
- monitoring and enforcement of the Companies Act including the role of the Central Government

(Report of the Working Group on the Companies Act, 1956, 1997, pages 2 to 3; Annual Report, Department of Company Affairs, 1997-98, pages 1 to 3; Chidambaram P., Statement of Objects and Reasons, 1997)

The Report of the Working Group and the first draft of the Companies Bill 1997 were completed and submitted to the Government (the Department of Company Affairs) in May 1997. After this, the Report and Bill were widely disseminated and discussed. Written representations on the Bill were sent to Working Group and the DCA by all parties interested in the Bill and meetings were held between these parties and the Working Group and the DCA. The parties interested in the Companies bill are given in appendix 17. *(Chidambaram P., Statement of Objects and Reasons, 1997; interviews with senior Government officials on 10th November 1998 and 17th November 1998)*

The Working Group and DCA considered the various suggestions and responses they received before finalising the bill that was eventually tabled in Parliament. There were only a few differences between the first draft of the Companies Bill 1997 prepared in May 1997 by the Working Group and the Companies Bill 1997 that was introduced into Parliament in August 1997. These included:

- the setting up of a National Advisory Committee on Accounting Standards to advise the Government on accounting policies and to issue accounting standards. *(Section 415 of Companies Bill 1997, August 1997)*

- the requirement for companies with redeemable debentures to create a debenture redemption reserve out of their profits every year until such debentures were redeemed. *(Section 105 of Companies Bill 199, August 1997)*

- the establishment of a fund by the Central Government for investors' education and protection. *(Section 414 of Companies Bill 1997, August 1997)*

- the appointment by the Central Government of Company Prosecutors for conducting prosecutions arising out of the Companies Act. *(Section 413 of Companies Bill 1997, August 1997)*

The Companies Bill 1997 was introduced in Parliament, in the Rajya Sabha, on 14 August 1997. The Bill was then referred to the Standing Committee on Finance for review. During this review, the Standing Committee on Finance interacted with all the parties interested in the Companies Bill 1997 requesting both written and oral representations from these parties. The parties interested in the Companies Bill 1997 are given in appendix 17. *(Annual Report, Department of Company Affairs, 1997-98, pages 1 to 3; Chidambaram P., Statement of Objects and Reasons, 1997; interviews with senior Government officials on 10th November 1998 and 17th November 1998)*

The Finance Standing Committee had still not reported by the end of 1998, the time period covered by this thesis. This was due to uncertainty in the political situation of the country. After the Companies Bill 1997 had been referred to the Finance Standing Committee, there were two parliamentary elections in India in a very short space of time. Despite the elections, no single political party had gained a working majority and hence the country had been governed by coalition governments which had not proved very stable. This had led to a delay in the work of Parliament including the Finance Standing Committee. *(Chapter 4; interviews with senior government officials on 10th November 1998 and 17th November 1998)*

Due to the delay in the promulgation of the Companies Bill 1997, the Government of India decided to issue some of the regulations contained in the Bill in an Ordinance. Under powers contained in the constitution of the India, the President has the right to give effect to provisions of parliamentary bills which are in the process of promulgation but are being delayed in the promulgation of

the bills. This power was used, at the instigation of the Department of Company Affairs, to promulgate some of the regulations of the Companies Bill 1997 in an Ordinance, the Companies (Amendment) Ordinance 1998, amending the Companies Act 1956 on 31st October 1998. This ordinance contained regulations on

- buy back of shares by companies. *(Clause 4 of the Companies (Amendment) Ordinance 1988)*
- sweat equities (equities issued at a discount or for non-cash consideration. *(Clause 5 of the Companies (Amendment) Ordinance 1988)*
- nomination and transmission of shares. *(Clause 7 of the Companies (Amendment) Ordinance 1988)*
- the establishment of a fund for investor education and protection. *(Clause 10 of the Companies (Amendment) Ordinance 1988)*
- the constitution of a National Advisory Committee on Accounting Standards. *(Clause 11 of the Companies (Amendment) Ordinance 1988)*
- giving some legal backing to accounting standards mandatory. *(Clause 12 of the Companies(Amendment) Ordinance 1988)*
- loans by companies to their directors. *(Clauses 13 and 14 of the Companies (Amendment) Ordinance 1988)*
- inter-corporate investments. *(Clause 16 of the Companies (Amendment) Ordinance 1988)*

In common with the other changes to the Companies Act discussed in chapters 6 to 8, the attempt to promulgate the Companies Bill 1997 can be analysed using the theoretical framework proposed in chapter 3. The change can be broken down into three phases, a source phase, a diffusion phase and a reaction phase as follows.

Analysis of the attempt to promulgate the Companies Bill 1997

The Source Phase

Despite India's attempt to develop a healthy economy since independence India's economy in the late 1980's and early 1990's was in crisis with large foreign exchange and balance of payment deficits. To deal with these problems the Government of India decided to liberalise the economy in 1991. Liberalisation measures included opening up the economy to foreign companies, reducing foreign exchange controls and reducing the licensing of companies. *(Chapter 4)*

The regulatory framework surrounding the corporate sector too needed reforming. The Companies Act 1956 had came into being when India had had a mixed economy with economic planning together with a private sector controlled by the Government. *(Chapter 4)*

The Companies Act 1956 too had introduced strong controls over the corporate sector for example placing restrictions on, and requiring government approval, for many company transactions. These controls and restrictions were added to in the 1970's and the 1980's. In 1988 some of the regulations were relaxed a little but the Companies Act 1956 still contained strong controls over the corporate sector. The Companies Act 1956 also included strong legal accounting regulations which covered the formats and disclosures in the annual report, company secretarial requirements and auditing requirements. *(Companies Act 1956, Chapters 6 to 8)*

After liberalisation, the general view was that the Companies Act 1956 was out of date and not conducive to the growth of the Indian corporate sector. An attempt was therefore made to revise the Companies Act 1956 in 1993 to take into account the new economic system being implemented in India with the issue of the a draft companies bill, the Companies Bill 1993. This was withdrawn after criticisms from all parties interested in the Companies Act that the Bill did not

address the major issues affecting the corporate sector. *(Report of the Working Group on the Companies Act, 1956, 1997, pages 2 to 3; interviews with senior government officials on 10th November 1998 and 17th November 1998; interviews with senior accounting personnel in companies on 27th October 1998 29th October 1998, 2nd November 1998 and 5th November 1998)*

Then in 1996, the Finance Minister of the newly elected, left wing coalition Government set in motion a review and complete revision of the Companies Act 1956, including changing the accounting provisions. A Working Group was constituted to undertake the review of the Companies Act 1956 and to rewrite the Act. The main aims of the review were to:

- facilitate the growth of the Indian corporate sector under a liberalised and highly competitive environment
- simplify rules and procedures
- incorporate international practices into Indian company law
- restore corporate democracy and impose obligations on the Board of Directors
- protect the rights of all stakeholders in companies
- incorporate good corporate governance into the corporate sector

(Chidambaram P., Statement of Objects and Reasons, 1997)

Thus, once again, it is seen that the changes to accounting regulation included in the Companies Act, are initiated from outside the accounting system and for economic reasons. The source phase was spread out over a number of years and there was no one single change stimulating event. Instead changes were initiated due to the Government's concern to facilitate the growth of the national economy combined with the perception that the Companies Act 1956 was outdated and hampered the growth of the Indian corporate sector in a liberalised environment. The brief attempt to promulgate the Companies Bill 1993 and the criticisms of this Bill also contributed to the need for a complete revision of the Companies Act.

In addition the corporate sector also called for changes and liberalisation of the Companies Act 1956 in line with the general liberalisation of the economy and in line with international practice. Thus the corporate sector were influential in the source phase, calling for changes to the Companies Act 1956 which was accepted by the Government. *(interviews with senior government officials on 10th November 1998 and 17th November 1998; interviews with senior accounting personnel in companies on 27th October 1998 29th October 1997, 2nd November 1998 and 5th November 1998; Chidambaram P., Statement of Objects and Reasons, 1997)*

Thus the motivation for changing the Companies Act 1956 and the accounting regulations contained in the Act came from outside the accounting system. The change stimulating event was the Government's perception, partly in response to arguments presented by the corporate sector, that the Companies Act 1956 needed to be reviewed in light of the liberalisation of the economy and in line with international practices.

The Diffusion Phase

The diffusion phase of the attempt to promulgate the Companies Bill 1997 can be broken down into two distinct phases:

- the Working Group review of the Companies Act 1956 and its drafting of the Companies Bill 1997 (August 1996 to May 1997)
- the introduction of the Companies Bill 1997 in Parliament and the review of the Bill by the Finance Standing Committee Bill through Parliament (August 1997 to date).

The review of the Companies Bill 1997 had not been completed by December 1998, the time period covered by the thesis, due to political instability and uncertainty leading to delays in parliamentary business.

As for the other major changes to the Companies Act 1956, analysed in chapters 6 to 9, both intra-system activity (activity between the regulatory institutions within the accounting system) and trans-system activity (activity between social

systems neighbouring the accounting system and the accounting system) are important in the diffusion phase of the change.

Intra-system activity is seen between the Government (the Department of Company Affairs) and the accounting profession (individual accountants, accounting firms and the professional accounting bodies) and legal accounting regulation. Trans-system activity is seen between Parliament, the corporate sector, the capital markets (stock exchanges and the Securities and Exchange Board of India) and the international system and legal accounting regulation.

Both intra-system activity and trans-system activity are discussed below.

Intra-system Activity

Interactions between the Department of Company Affairs and accounting regulation in the Companies Act 1956

As in all the changes to the Companies Act since independence, the Government were important in influencing the change to the Companies Act 1956 in the period 1996 to 1998.

The Finance Minister of the Government initiated the review of the Companies Act 1956 in his 1996 budget speech. The Department of Company Affairs (DCA) then constituted the Working Group, in line with the wishes of the Finance Minister and the cabinet, and set its terms of reference. These were to review the Companies Act in the light of liberalisation and to rewrite the Act. *(Chidambaram P., Statement of Objects and Reasons, 1997; Report of the Working Group on the Companies Act, 1956, 1997, page 1)*

The Working Group that was set up had a different structure to previous committees which had been set up to review the Companies Act. The members of the Working Group consisted mainly of professionals from the corporate sector and the accounting profession rather than mainly government officials. In

addition, the Working Group had no chairman. Instead a convenor was appointed who was the Secretary of the DCA (initially an additional secretary of the DCA who was later replaced by the Joint Secretary of the DCA). Thus the Government had the opportunity to present its point of view directly to the Working Group through the senior member of the DCA who was a member of the Working Group. However, there was less direct representation of the DCA in the Working Group than in previous committees set up by the Government to review the Companies Act 1956.

During its meetings, the Working Group met with all the different parties interested in the Companies Act and these included Government officials, both from the DCA and other Government departments such as the Central Board of Direct Taxes. Thus the DCA had ample opportunity to present its point of view, both directly and indirectly, to the Working Group and for the Working Group to take the DCA and the Government's view on the legislation it was drafting. *(Chidambaram P., Statement of Objects and Reasons, 1997; interview with senior government officials on 10th November 1998, 16th November 1998 and 17th November 1998).*

After the Report of the Working Group and the first draft of the Companies Bill 1997, were published, the Report and Bill were subject to much debate. During this debate, the parties interested in the Companies Act gave feedback on the Companies Bill 1997 to the Working Group and the DCA through written representations and in meetings with the Working Group and the DCA. *(Chidambaram P., Statement of Objects and Reasons, 1997; interview with senior government officials on 10th November 1998 and 17th November 1998).*

The DCA and the Government were satisfied with most of the provisions of the Bill drafted by the Working Group. The Bill did reduce Government involvement in some corporate activities in line with liberalisation and gave the corporate sector more control over their own affairs as they had been demanding and as seemed appropriate in an era of deregulation and competition. For example restrictions on the buy back of shares were reduced, restrictions on loans by companies to their directors were reduced, there were reductions in government approval for company transactions and disclosure requirements were

reduced. These are detailed under trans-system activity. *(Report of the Working Group May 1997)*

However, this deregulation was combined with some extra checks and balances to ensure that the corporate sector did not abuse its powers. This was done by increasing the disclosures required by companies, more efficient enforcement of the Act and an increase in the penalties for non-compliance with the Act. For example

- establishing a quasi independent tribunal, called the Company Law tribunal to help enforce the Companies Act. *(Clauses 8.2 to 8.5 of the Report of the Working Group, Sections 417 to 423 of the Companies Bill 1997, May 1997)*
- establishing private licensed registrars to take over some of the roles of the Registrar of Companies. *(Clauses 8.6 to 8.9 of the Report of the Working Group, Section 406 of the Companies Bill 1997, May 1997)*
- increasing significantly the penalties for non-compliance with the Act. *(Clause 8.13 of the Report of the Working Group, Sections 430 to 440 of the Companies Bill 1997, May 1997)*
- giving powers to the Government to appoint a Director General of Inspection and Investigation. *(Sections 402 to 406 of the Companies Bill 1997, May 1997)*
- requiring public companies to appoint audit committees. *(Clause 4.18 of the Report of the Working Group, Section 230 of the Companies Bill 1997, May 1997)*
- requiring large companies to appoint a chief accounts officer. *(Clause 5.26 of the Report of the Working Group, Section 172 of the Companies Bill 1997, May 1997)*
- retaining the cost accounting and cost audit requirements. *(Clause 5.27 of the Report of the Working Group, Section 189 of the Companies Bill 1997, May 1997)*
- requiring a directors' responsibility statement to be included in the directors report. *(Clause 5.19 of the Report of the Working Group, Section 173 of the Companies Bill 1997, May 1997)*
- requiring a secretarial compliance certificate to be sent to the Registrar where companies did not appoint a company secretary. *(Clause 4.19 of the Report of the Working Group, Section 256 of the Companies Bill 1997, May 1997)*
- increasing disclosures, for example
    - leased assets. *(Section 166 and Schedule I of the Companies Bill 1997, May 1997)*
    - foreign exchange transactions. *(Section 166 and Schedule I of the Companies Bill 1997, May 1997)*

- debt exposure. *(Section 166 and Schedule I of the Companies Bill 1997, May 1997)*

The amendments to the Companies Bill 1997 drafted by the Working Group instigated by the DCA also increased controls over the corporate sector. These amendments included:

- giving powers to the Government to establish a fund called the Investors' Education and Protection Fund. *(Section 414 of the Companies Bill 1997, August 1997)*
- giving powers to the Government to set up an advisory committee, called the National Advisory Committee on Accounting Standards, to advise the Government on the formulation of accounting policies and accounting standards for adoption by companies. *(Section 415 of the Companies Bill 1997, August 1997)*
- giving powers to the Government to appoint Company Prosecutors for conducting prosecutions arising out of the Companies Act. *(Section 433 of the Companies Bill 199, August 1997)*

Thus, although the DCA did not draft the Companies Bill 1997, they were able to influence the Companies Bill significantly. They were represented on the Working Group which drafted the Bill, held their own meetings with parties interested in the Bill and were able to have provisions inserted in the Companies Bill after it had been drafted by the Working Group and before it was introduced into Parliament. These provisions generally increased Government control over the corporate sector and gave the DCA increased powers over the corporate sector.

After the DCA made these amendments to the Companies Bill 1997 in May 1997, the Bill was introduced into Parliament on 14th August 1997. The Bill was then referred to the Standing Committee on Finance for review and after this review would have been debated in both Houses of Parliament. The Review of the Companies Bill by the Finance Standing Committee had not been completed by the end of 1998, the time period covered by this thesis. However, it is expected that the DCA and the Government would also have been important in influencing the Companies Bill 1997 and steering it through the parliamentary system, as they had been for the other major changes to the Companies Act

discussed in chapters 6 to 8. *(interviews with senior government officials on 10th November 1998 and 17th November 1998)*

As in previous changes to the Companies Act 1956, the Government, via the DCA, significantly influenced the Companies Bill 1997, including its accounting provisions. The DCA directly influenced the Companies Bill 1997 that was drafted by the Working Group since they were represented on the Working Group. However, the DCA exerted less direct influence than in previous amendments to the Companies Act since they did not draft the Bill themselves.

But the DCA did exert significant indirect influence over the Companies bill 1997. The DCA constituted the Working Group and set its terms of reference. They also held meetings with the parties interested in the Bill, sent in written representations to the Working Group and held meetings with the Working Group. They also influenced the Companies Bill 1997 by introducing provisions into the Bill after it was drafted by the Working Group and before it was introduced into Parliament. Hence the DCA probably influenced the Companies Bill the most out of all the parties interested in the Companies Bill 1997.

Interactions between the accounting profession and accounting regulation in the Companies Act 1956

The accounting profession (individual accountants, accounting firms and professional accounting bodies) were very involved in the promulgation of the Companies Bill 1997. Many accounting and auditing regulations were included in the Bill and these significantly affected the accounting profession in India. The accounting profession, mainly through the professional accounting bodies, the Institute of Chartered Accountants of India (ICAI) , the Institute of Cost and Works Accountants of India (ICWAI) and the Institute of Company Secretaries of India (ICSI) were involved in the attempt to promulgate the Companies Bill 1997. The interactions between the professional accounting bodies and accounting firms and accounting regulation in the Companies Bill 1997 are discussed below.

The Institute of Chartered Accountants of India

The Institute of Chartered Accountants of India (ICAI) were very interested and involved in the provisions of the Companies Bill 1997 and in the process of its promulgation. The ICAI were not directly represented in the Working Group set up to review the Companies Act 1956. However, a partner of an auditing firm, who was a member of the ICAI, was a member of the Working Group and represented the views of both the auditing profession and the ICAI as the interests of both these parties were similar, as shown in appendix 16.

In addition, the ICAI were one of the parties that the Working Group interacted with during their review of the Companies Act 1956. The ICAI also participated in the feedback on the Companies Bill 1997 which was drafted by the Working Group, by sending in written representations to both the Working Group and the DCA and meeting with both the Working Group and the DCA. *(interviews with senior government officials on 10th November 1998 and 17th November 1998; interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998; Report of the Working Group on the Companies Act 1956, pages 1 to 3)*

There were some provisions in the Report of the Working Group and the Companies Bill 1997 which the ICAI were in favour of. In general, the ICAI were supportive of the reduction in the regulation of the corporate sector since they supported the views of the companies who they audited and were closely linked too. In addition, the ICAI supported some of the accounting provisions in the Report of the Working Group and the Companies Bull 1997 which included:

- the appointment of a chief accountants officer for large companies who was expected to be a member of the ICAI. This would increase the employment opportunities for chartered accountants. *(Clause 5.26 of the Report of the Working Group, Section 172 of the Companies Bill 1997, May 1997)*

- the provisions allowing companies to prepare group accounts on a voluntary basis, bringing India in line with international practice and again creating more employment opportunities for chartered accountants. *(Clause 5.25 of the Report of the Working Group, Section 168 of the Companies Bill 1997, May 1997)*

- the requirement for large companies to have audit committees in line with international practice which would increase the profile of the statutory

audit. *(Clause 4.18 of the Report of the Working Group, Section 230 of the Companies Bill 1997, May 1997)*

- the requirement for a directors' responsibility statement on accounting responsibilities which would help to reduce the expectations gap. *(Clause 5.19 of the Report of the Working Group, Section 173 of the Companies Bill 1997, May 1997)*

In addition, the Working Group made recommendations which were not in the Companies Bill but supported the role of the ICAI. These included:

- that the ICAI should review the cashflow statement requirement issued by SEBI and the stock exchanges and in future prepare their own standards on the cashflow statement. *(Clause 5.15 of the Report of the Working Group, 1997)*

- that all accounting and auditing statements should be prescribed by the ICAI. They also recommended that if other institutions felt that they had to issue accounting standards, these should be consistent with the standards issued by the ICAI. *(Clauses 5.21 to 5.23 of the Report of the Working Group, 1997)*

However, the ICAI were concerned with one of the accounting provisions which was introduced into the Companies Bill 1997 by the DCA. This was the setting up of the National Advisory Committee on Accounting Standards which became part of the Companies Bill 1997 after it had been drafted by the Working Group and before it was introduced into Parliament. The role of the National Advisory Committee was to advise the Government on accounting standards and issue accounting standards in its own right. This provision had been suggested to the DCA by a senior academic due to criticisms of the ICAI which included:

- the lack of independence of the ICAI

- a view that accounting standard setting was an important tool for economic and social development and, as such, was too important to be left in the hands of an Institute which represented one group in society.

- a lack of transparency in the activities of the ICAI including standard setting.

- a consensual approach to standard setting which led to standards which contained too many choices and controversial standards being watered down, not promulgated or not made mandatory

- a lack of an effective enforcement procedure for accounting standards

(interview with senior Indian academic on 28th September 1998; interviews with senior Government officials on 10th November 1998 and 17th November 1998; interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998)

The setting up of a National Advisory Committee to advise on accounting standard setting was the Indian Government's response to the above criticisms of the ICAI and its standard setting process. The initial recommendation from the senior Indian academic had been that accounting standard setting should be undertaken by an independent Securities and Exchange type body set up along American lines. However, instead of following the American model, the Indian Government chose to set up an institution which fitted in with the cultural and social context of India.

Unlike in Anglo-Saxon countries, self regulation, although discussed, had not been used very often in India. Instead, strong Government control usually combined with statutory legislation had been used to regulate many social systems in India since independence including accounting and the corporate sector. For example the Company Law Board and the Securities and Exchange Board of India (SEBI) had both been set up as advisory committees to the Government initially. These institutions were then set up as semi-independent statutory bodies with their own powers once they had been in existence for some time and had proved successful.

Rather than setting up a Securities and Exchange type body, the DCA recommended the setting up of a National Advisory Committee to advise Government on accounting standards, in a similar way to the setting up of other institutions in India. It is expected that in time, if the National Advisory Committee proves successful, it too will be set up as an independent statutory body.

The role of the National Advisory Committee was to advise Government on accounting policy and to issue accounting standards which companies would have to follow. The National Advisory Committee would contain members of all

the parties interested in accounting and hence would represent the wider interest group rather than just primarily accountants. In addition the standards issued by the National Advisory Committee would have some legal backing and status which would help in the enforcement of the standards. Thus in response to the criticisms of standard setting by the ICAI, the Indian Government chose to use a regulatory system which they had used many times and which fitted into the cultural and social context of the country.

The ICAI were very worried about this proposal. They did not want standard setting to be taken over by a Government body. They argued that they had successfully set up the standard setting process and that they were continually improving this process. For example, they were addressing the criticisms of the representation of the wider interest group and the enforceability of the standards. Indeed, the legal backing given to accounting standards was welcomed by the ICAI but they wanted to retain control over the standard setting process itself and wanted to issue accounting standards with legal backing themselves. Issuing standards obviously gave the ICAI power, status and influence and they did not want this to be reduced by the standard setting process being taken over by the Government. The ICAI therefore put forward arguments to support keeping the accounting standard setting in the hands of the ICAI which included:

- the members that would be on the National Advisory Company were already represented in the committee of the ICAI and were consulted in the standard setting process.

- the standard setting process was working reasonably well. Recently, the standards had been tightened up and enforcement was being addressed. Hence the ICAI should be allowed to continue with standard setting.

- there was no need to increase the level of bureaucracy and government involvement in accounting, particularly with liberalisation. Standard setting in the USA and the UK was undertaken by institutes similar to the ICAI and this was a suitable model which should be maintained.

(interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998)

These arguments were made strongly by the partner of the auditing firm who was a member of the Working Group. In addition, chartered accountants, the auditing firms and the ICAI made the same arguments in meetings with the Working Group and the DCA during the sitting of the Working Group and in the public debate of the Companies Bill 1997 that took place after the Bill was published.

However, the Government felt strongly that accounting and standard setting was important for economic development and hence should be undertaken by a Government body which consulted and represented all the parties interested in accounting and the economy and not by an institute which represented just one group in society. They also felt that the enforcement of standards would be improved if they were set by a Government body or institution. The Government's view was upheld and, at the instigation of the DCA, provisions dealing with the setting up of the National Advisory Committee were included in the Companies Bill 1997 which was introduced in Parliament in August 1997.

The ICAI were not happy with this and continued to make representations, through Members of Parliament who were accountants and other Members of Parliament whose views coincided with the Institute's views. Some of these Members of Parliament would have been part of the Finance Standing Committee and would have presented the views of the Institute during the Standing Committee's review of the Companies Bill 1997. In addition, the Finance Standing Committee called some parties to give evidence to the Standing Committee and the ICAI, auditing firms and individual accountants all gave evidence to this committee. *(interviews with senior Government officials on 10th November 1998 and 17th November 1998; interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998)*

The Finance Standing Committee had not completed its report on the Companies Bill 1997 by the end of 1998, the time period covered by the thesis and hence the representations received by the committee and its main finding could not be analysed. However, it appeared unlikely that the provisions relating to the

National Advisory Committee on Accounting Standards would be deleted from the Bill, despite the representations made by the ICAI. *(interviews with senior Government officials on 10th November 1998 and 17th November 199; interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998)*

Auditing firms and accounting regulation in the Companies Bill 1997

As well as the ICAI, the accounting firms were also involved in the promulgation of the Companies Bill 1997. A partner of a firm of Indian chartered accountants was a member of the Working Group and represented the views of the accounting firms and the ICAI of whom he was a member. In addition members of accounting firms met with the Working Group as it sat, sent in written representations on the Companies Bill 1997 and met with the Working Group and the DCA.

For the first time, perhaps, not all the auditing firms concurred with the view of the ICAI. There were generally two viewpoints expressed, one from the Indian auditing firms and one from international auditing firms. The Indian auditing firms had been operating in India since independence, some with links to international auditing firms and some with no international links. The ICAI regulated the auditing profession in India and only Indian auditing firms and Indian auditors who were members of the ICAI were allowed to undertake auditing work.

The ICAI is run by a council which is elected from its membership of chartered accountants, most of whom are auditors or work in industry. In general, the senior members of the ICAI are partners in Indian auditing firms. Thus the Indian auditing profession is actively represented by the ICAI and the views of the auditing firms and the ICAI are, not surprisingly, similar on most issues. Indeed the views of the Indian auditing firms on the Companies Bill 1997 were similar to that of the ICAI as outlined above. For example, the preparation of group accounts was welcomed by the auditing firms and the ICAI as was the fact that this was not made mandatory since this gave flexibility in whether group

accounts were prepared by companies or not. *(interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998; interviews with senior Government officials on 10th November 1998 and 17th November 1998)*

The international auditing firms had entered India after liberalisation and were trying to develop their businesses. Due to rules issued by the ICAI there were several restrictions on international accounting firms which included lack of recognition of foreign qualifications and international accounting firms not being able to undertake audits and practice in their international names.

The international firms were unhappy with this situation as they could only undertake consultancy work or undertake audits if they linked up with Indian partnerships and practised under the names of the Indian partnerships rather than in their internationally known names. The international auditing firms therefore took the opportunity given by the Companies Bill 1997 to lobby the DCA to try and get them to overturn some of the restrictions placed upon them by the ICAI. The DCA did take into account the views of the international auditing firms and considered whether to override the ICAI and allow international auditing firms to undertake audits in their international names. However, the DCA decided that this issue needed to be discussed further with all the professional accounting bodies in India. They therefore decided not to include this provision in the Companies Bill 1997, much to the relief of the ICAI and the Indian auditing firms. This issue is still ongoing at the moment. *(interviews with senior Government officials on 10th November 1998 and 17th November 1998; interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998)*

In relation to the provisions of the Companies Bill 1997, the international accounting firms supported any moves towards international practice and considered that the Companies Bill 1997, although a great improvement on the Companies Act 1956, was still too restrictive in many areas. In addition they considered that the Working Group and the DCA had lost a good opportunity to make international practices such as the preparation of group accounts

mandatory. *(interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998; interviews with senior Government officials on 10th November 1998 and 17th November 1998)*

The Institute of Cost and Works Accountants of India

The Institute of Cost and Works Accountants of India (ICWAI) were also involved in the promulgation of the Companies Bill 1997. The ICWAI were not directly represented in the Working Group. Instead a partner of a firm of cost accountants, who was a member of the ICWAI, represented the cost accountants and the ICWAI.

The main provisions that the ICWAI were interested in were the provisions in the Companies Act 1956 relating to the requirement for companies to keep cost accounting records and the requirement for companies to have mandatory cost audits when notified by the Government. *(interview with senior member of the accounting profession on 17th November 1998; interview with senior academic on 7th November 1998)*

There was some discussion of removing the cost audit requirements from the Companies Act 1956 by the Working Group. *(Clause 5.27 of the Report of the Working Group, 1997)* The ICWAI and the cost accountants in practice were very concerned at the possible deletion of mandatory cost audit from the Companies Act 1956. The ICWAI were concerned that companies would not have cost audits performed if they were not mandatory which would adversely affect both the livelihood of the cost accountants and the status of the cost accounting profession and the ICWAI. *(interview with senior member of the accounting profession on 17th November 1998; interview with senior academic on 7th November 1998)*

Furthermore, the ICWAI were keen to promote the benefits of cost accounting. They argued that cost accounting and cost audit were important to engender cost consciousness in companies which was vital for economic success. Indeed, they argued that even without a mandatory requirement for cost accounting and cost audit, there was a market for these services as they were an important tool for economic development and would help the competitive position of companies.

However, the ICWAI argued that persuading companies of this and ensuring that companies kept cost accounting records would be harder if the cost audit provisions were removed from the Companies Act. *(interview with senior member of the accounting profession on 17th November 1998; interview with senior academic on 7th November 1998)*

The ICWAI were successful in arguing their case of the importance of cost accounting and cost auditing in the Companies Act. The DCA and the Government supported this view as they too recognised the importance of cost accounting in promoting cost consciousness in companies which was important for economic growth. Thus cost accounting and cost audit provisions were retained in the Companies Bill 1997 .

It is also expected that the ICWAI would have been involved in the parliamentary stage of the promulgation of the Companies Bill 1997, had this been successful. The ICWAI would have given evidence to the Finance Standing Committee in the parliamentary review of the Companies Bill 1997 and would have lobbied Members of Parliament to present their views in the parliamentary debates on the Bill. The Finance Standing Committee had not completed its report on the Companies Bill 1997 by the end of 1998, the time period covered by the thesis and hence the representations received by the committee and its main findings could not be analysed.

The Institute of Company Secretaries of India

The Institute of Company Secretaries of India (ICSI) was also involved in the promulgation of the Companies Bill 1997. The ICSI itself was represented in the Working Group by the president of the ICSI at that time. The ICSI was the only professional accounting body to be directly represented in the Working Group. Indeed, the ICSI had been created in the 1960's to provide expertise in the administration and application of the Companies Act and as such could be argued to be the Institute most closely linked with the whole Companies Act. Hence it was seen as appropriate to have the ICSI represented in the Working Group.

In addition to direct representation in the Working Group, the ICSI and company secretaries in practice and in industry met with the Working Group, as did all parties interested in the revision of the Companies Act. The ICSI and company secretaries also gave feedback to Working Group and the DCA on the Companies Bill 1997 drafted by the Working Group.

There were several provisions which affected the ICSI and company secretaries directly and these included:

- the recommendation that companies with a paid up capital of 2 crore rupees should have a full time company secretary who was to be a member of the ICSI. For other companies, the employment of a full time company secretary would be optional. *(Clause 4.19 of the Report of the Working Group, Section 256 of the Companies Bill 1997, May 1997)*

- the requirements for companies who did not employ company secretaries to send a secretarial compliance certificate to the Registrar. *(Clause 4.19 of the Report of the Working Group, Section 256 of the Companies Bill 1997, May 1997)*

- The setting up of a Company Law Tribunal and the appointment of a Director General of Inspection and Investigation with whom the company secretary would have to interact with and report to. *(Clauses 8.2 to 8.5 of the Report of the Working Group, Sections 417 to 423 of the Companies Bill 1997,May 1997 and Section 402 of the Companies Bill 1997, August 1997)*

The ICSI generally supported the above provisions since these provisions would provide employment opportunities for company secretaries and increase the profile of company secretaries. The ICSI were perhaps the most directly influential accounting body in the attempt to promulgate the Companies Bill 1997 since they were directly represented in the Working Group which prepared the first draft of the Companies Bill 1997. The ICSI and company secretaries in practice and in companies also indirectly influenced the Companies Bill sending in written representations to, and holding meetings with, the Working Group and the DCA. Generally the ICSI were supportive of the Companies Bill 1997 as it contained provisions which increased the role and profile of company secretaries. *(Interview with senior member of the accounting profession on 20th November 1998)*

As well as being directly involved in the Working Group review of the Companies Act 1956 and in the drafting of the Companies Bill 1997, the ICSI

would also have been involved in the parliamentary review of the Companies Bill. The Finance Standing Committee invited all parties to give evidence on the Companies Bill 1997 and the ICSI and individual company secretaries and firms of company secretaries would have given written and oral evidence to the Finance Standing Committee. The Finance Standing Committee had not completed its report on the Companies Bill 1997 by the end of 1998, the time period covered by the thesis and hence the representations received by the committee and its main finding could not be analysed.

Trans-system Activity

Interactions between Parliament and accounting regulation in the Companies Act 1956

As for all the other changes to the Companies Act 1956, Parliament influenced the changes to the Companies Act 1956, including changes to the accounting provisions in the 1990's, as the changes were incorporated into a Companies Bill which was promulgated through the parliamentary system. The Companies Bill 1997 was introduced in the Rajya Sabha in August 1997 and was immediately referred to the Finance Standing Committee for review. The Finance Standing Committee was an all party committee of Parliament and contained representatives of both Houses of Parliament and Members of Parliament from all the major political parties in India. The Bill was introduced in the Rajya Sabha, at the recommendation of the DCA, due to the uncertainty in the political situation. No party had an absolute majority and a coalition of parties were in power. The stability of such a coalition was not high and it was unclear how long such a coalition would last in power. By introducing the Bill in the Rajya Sabha, it would not lapse if the Government collapsed, thus giving it a greater chance of being promulgated. *(interviews with senior government officials on10th November 1998 and 17th November 1998)*

If the Companies Bill 1997 had been promulgated, Parliament would have had the opportunity to influence the Bill during the review of the Companies Bill 1997 by the parliamentary Finance Standing Committee. After this review, the

Bill would have been debated in both the Rajya Sabha and the Lok Sabha giving Members of Parliament further opportunity to debate the Bill and influence its provisions.

During both these stages, there would have been opportunity for all parties interested in the Companies Bill 1997 to present their views, either directly to the parliamentary committee themselves or indirectly by lobbying Members of Parliament to present their point view and argue their cases. This did not happen since the political situation in India affected the promulgation of the Companies Bill 1997. There were elections after the Companies Bill 1997 was referred to the Finance Standing Committee, which delayed the review of the Bill. This review still had not been completed by the end of 1998, the time period for this thesis. In reaction to this delay, the Government, issued an ordinance, the Companies (Amendment) Ordinance 1988, amending the Companies Act. This is discussed in the reaction phase of the promulgation of the Companies Act 1956.

Interactions between the Corporate Sector and accounting regulation in the Companies Act 1956

The corporate sector were also influential in the diffusion phase of the promulgation of the Companies Act 1997. After liberalisation of the economy in 1991, the corporate sector called for changes to the Companies Act 1956. They felt that the provisions of the Companies Act 1956 to be too restrictive with too many unnecessary controls over the corporate sector and too much Government involvement in the affairs of companies. The Companies Act 1956 had been promulgated when the economy had been planned and heavily controlled by the Government and this was reflected in the Companies Act 1956. Many of the provisions of the Companies Act were no longer appropriate due to the opening up the economy. Indeed, following the Companies Act 1956 meant that Indian companies were in an unfair competitive position in comparison with foreign companies. Foreign companies could now enter the Indian markets without having to follow what the Indian corporate sector felt were the onerous

requirements of the Companies Act with its unnecessary prohibitions, increased bureaucracy and government intervention. Examples of these included:

- restrictions on inter-corporate loans and investments. *(Companies Act 1956, Sections 370-374)*
- restrictions on loans by companies to their directors were made. *(Companies Act 1956, Section 295)*
- Government approval required for company transactions. For example, Government approval for the following was needed:
    - moving registered offices. *(Companies Act 1956, Section 17)*
    - transfer of shares. *(Companies Act 1956, Section 120)*
    - changes to the memorandum and articles. *(Companies Act 1956, Schedule I)*
- all companies were required to follow the same regulations irrespective of the level of public interest in the companies. *(Companies Act 1956, Sections 3 and 43)*

In addition, the corporate sector, particularly the larger companies, felt that there was a need to move towards international practice and there was a general feeling that companies needed more flexibility and control over their own affairs. *(Interviews with senior accounting personnel in companies on27th October 1998, 29th October 1998, 2nd November 1998 and 5th November 1998)*

The corporate sector therefore made a strong case for the Companies Act 1956 to be changed. This was done by companies themselves and also by trade associations and chambers of commerce representing the companies. These included the three main trade associations, Confederation of Indian Industry, Federation of Indian Chambers of Commerce and Associated Chambers of Commerce. The Government too felt the need for change and accepted the validity of the case presented by the corporate sector for change to the Companies Act.

In response to these requests, the Government drafted the Companies Bill 1993 to amend the Companies Act 1956. However, this Bill did not make any major changes to the Companies Act. The corporate sector and other interested parties

in the Companies Act did not consider that the Companies Bill 1993 would change the Companies Act 1956 significantly. Due to the many criticisms of the Companies Bill 1993, the Government decided to withdraw the Bill. *(interviews with senior accounting personnel in companies on 27th October 1998, 29th October 1998, 2nd November 1998 and 5th November 1998; interviews with senior government officials on10th November 1998 and 17th November 1998)*

The corporate sector continued to ask for changes to the Companies Act 1956. In 1996, the Finance Minister of the Government, too felt strongly that it was time for a major revision of the Companies Act 1956. The views of the Government and the corporate sector coincided and hence the calls for change led to the start of the promulgation of the Companies Bill 1997. This was done by the Government via the DCA who set up a Working Group to review the Companies Act 1956 and draft the Companies Bill 1997.

As well as being an important motivation for change, the corporate sector influenced the Companies Bill 1997 itself. Two members of the working group represented the corporate sector and hence were able to present the views of the corporate sector directly in the meetings of the Working Group. The corporate sector also indirectly influenced the Working Group by interacting with the Working Group and the DCA, as did all the parties interested in the Companies bill, and this included meeting with the Working Group and the DCA and sending written representations to them. *(Report of the Working Group, pages 1 to 3; Interviews with senior accounting personnel in companies on 27th October 1998, 29th October 1998, 2nd November 1998 and 5th November 1998; interviews with senior government officials on10th November 1998 and 17th November 1998)*

The corporate sector were quite successful in reducing the regulations in the Companies Bill 1997. These included

- restrictions on the buy back of shares were reduced. *(Clause 3.14 of the Report of the Working Group, Section 43 of the Companies Bill 1997, May 1997)*
- restrictions on inter-corporate loans and investments were reduced. *(Clauses 4.20 to 4.23 of the Report of the Working Group, Section 254 of the Companies Bill 1997, May 1997)*

- restrictions on loans by companies to their directors were reduced. *(Clause 4.9 of the Report of the Working Group, Section 233 of the Companies Bill 1997, May 1997)*

- reductions in government approval for company transactions was seen. For example Government approval for the following were eliminated:

  - moving registered offices, *(Clause 2.19 of the Report of the Working Group, Section 10 of the Companies Bill 1997, May 1997)*

  - transfer of shares *(Clauses 3.4 of the Report of the Working Group, Section 94 and deletion of Section 108 in the Companies Bill 1997, May 1997)*

  - changes to the memorandum and articles. *(Clauses 2.15 to 2.18 of the Report of the Working Group, deletion of Schedule 1 in the Companies Bill 1997, May 1997)*

- a better classification of Companies with different levels of Government control was introduced. The greatest Government control was over public listed companies in which there was strong public interest and the least Government control was over private companies where there was not a strong public interest. *(Clauses 2.2 and 2.3 of the Report of the Working Group, Section 3 of the Companies Bill 1997, May 1997)*

- disclosure requirements were reduced. For example, the following disclosures removed:

  - investments that were not material *(Clause 5.10 of the Report of the Working Group, Section 166 of the Companies Bill 1997, May 1997)*

  - installed and licensed capacity (Clause 5.18 of the Report of the Working Group, deleted from Schedule I in the Companies Bill 1997, May 1997)

The response of the corporate sector was generally favourable to the Companies Bill 1997 as many of its provisions did reduce the regulations they had to follow and introduced provisions which gave them flexibility in areas which they considered were important. For example in the buy back of shares, inter-corporate investments and the option to produce group accounts if they so desired.

There was some concern over a few of the provisions such as the National Advisory Committee but on the whole, the Companies Bill 1997 was very much welcomed by the corporate sector as it introduced much more flexibility in their affairs which they wanted. *(Interviews with senior accounting personnel in companies on 27th October 1998, 29th October 1998, 2nd November 1998 and 5th November 1998)*

When the Companies bill 1997 was introduced in Parliament and referred to the Finance Standing Committee for review, the corporate sector gave evidence to the standing committee. However, the standing committee had not reported by the end of 1998, the time period covered by this thesis and hence the representations received by the standing committee could not be analysed. However, it is expected that the views of the corporate sector would have been influential in any changes made by the standing committee to the provisions of the Companies Bill 1997.

Interactions between the capital markets (SEBI and the stock exchanges) and accounting regulation in the Companies Act 1956

Unlike in the previous changes to the Companies Act discussed in chapters 6 to 8, the capital markets were an important influence and consideration on the changes to the Companies Act 1956 in the 1990's. The role of the capital markets had increased importantly since the 1980's with stock exchanges becoming more important for the raising of finance by companies. Until the 1990's India had a system of regional stock exchanges which were member based organisations who regulated themselves but were also regulated by the Government. The stock exchanges and companies who listed for the first time or raised additional capital were, until 1988, regulated by the Comptroller of Capital Issues who was in the Ministry of Finance. Other transactions by listed companies on the stock exchanges were directly regulated by the Ministry of Finance and not by the Comptroller of Capital Issues. *(Chapter 4; interviews with senior representatives of the stock exchanges and SEBI on 2nd November 1998, 5th November 1998 and 6th November 1998)*

In 1988, a new regulatory institution, the Securities and Exchange Board of India (SEBI) was set up under the Ministry of Finance to regulate the capital markets. Initially SEBI was set up as an advisory committee to the Ministry of Finance and in 1992 it became an independent statutory body with its own powers to regulate the capital markets. SEBI has proved to be a strong regulatory body since its inception and has been active in regulating the stock exchanges and listed companies. This has included accounting regulation, in particular with the requirement for companies to prepare a cashflow statement in 1996. *(Chapter 4; interviews with senior representatives of the stock exchanges and SEBI on 2nd November 1998, 5th November 1998 and 6th November 1998)*

The stock exchanges and SEBI were very much involved in the promulgation of the Companies Bill 1997. They met with the Working Group and sent in feedback on the Companies Bill 1997 to the Working Group and the DCA. Furthermore, the Working Group, recognising the importance of the capital markets in a liberalised economy, took into account the effect of their proposals on the capital markets and indeed made recommendations for some of the regulations of the Companies Act to be taken over by SEBI and the stock exchanges. These included:

- that regulations on the prospectus should be regulated by SEBI and not by the Companies Bill. *(Clause 3.3 of the Report of the Working Group, 1997)*
- that regulations on new financial instruments should be drafted by SEBI and not included in the Companies Bill. *(Clause 3.6 to 3.8 of the Report of the Working Group, 1997)*
- that regulations on employee stock options should be drafted by SEBI and not included in the Companies Bill. *(Clause 3.20 of the Report of the Working Group, 1997)*
- that disclosures on how companies used funds raised in fresh capital issues should be continued to be regulated by SEBI and not included in the Companies Bill. *(Clause 5.6 of the Report of the Working Group, 1997)*

Thus SEBI and the stock exchanges would be taking on some of the powers previously exercised by the Government under the Companies Act 1956. These powers increased SEBI's control over the capital markets and listed companies and this included control over accounting regulations.

However, in the area of cashflow statements, the Working Group criticised the cashflow statement requirement for listed companies required by SEBI and the stock exchanges as being confusing and uninformative. They recommended that the ICAI review the cashflow requirement and prepare their own standards in this area. However, this was just a recommendation and did not reduce the control of SEBI over the stock markets.

In addition to the regulations which would directly affect the role and powers of SEBI and the stock exchanges, these institutions were in favour of the liberalisation of the corporate sector. There was support for reducing regulations over the corporate sector to make the corporate sector more competitive and to facilitate the growth of companies. It was also hoped that some of the provisions of the Companies Bill 1997 such as the buy back of shares and inter-corporate investments, would help to stimulate activity in the capital markets which had seen a decline in the late 1990's after being very buoyant after liberalisation until the mid 1990's. *(interviews with senior representatives of the stock exchanges and SEBI on 2nd November 1998, 5th November 1998 and 6th November 1998)*

SEBI and the stock exchanges would also have been influential after the Companies Bill 1997 was introduced in Parliament. In common with all the other parties interested in the Companies Act 1956, the capital markets gave evidence to the Finance Standing Committee which was reviewing the Companies Bill 1997. It is also expected that the capital markets would have lobbied Members of Parliament to argue their case in the debates that would have taken place in the Houses of Parliament after the review of the Companies Bill 1997 by the Finance Standing Committee. The Finance Standing Committee had not reported by the end of 1998, the time period covered by this thesis and hence the representations reviewed by the Committee could not be analysed.

Interactions between the international system and accounting regulation in the Companies Act 1956

The international community were also important in influencing some of the changes in India in the 1990's. India had lost the confidence of the international community in the 1990's and international institutions such as the World Bank required India to change its economy. Liberalisation of the economy, along the lines of the UK and the USA economies, had to be undertaken by India in response to its economic crisis. *(Chapter 4)*

International influences, particularly of the UK and the USA, were also seen in the Companies Bill 1997. Unlike for the promulgation of the Companies Act 1956, there was no direct comparison of Indian legislation with the legislation of the UK or any other country. However company law in other countries was referred to by the Working Group. For example, comparisons were made to company law in the UK and USA in the following provisions:

- group accounts *(Clause 5.25 of the Report of the Working Group, 1997)*
- financial instruments *(Clause 3.6 to 3.8 of the Report of the Working Group, 1997)*
- buy back of shares *(Clause 3.9 to 3.13 of the Report of the Working Group, 1997)*
- the setting up of an Indian depository system *(Clause 314 of the Report of the Working Group, 1997)*
- the use of private licensed registrars. *(Clause 8.6 to 8.9 of the Working Report, 1997)*

In addition, the successful economies in South East Asia, for example the economy of Singapore, was also mentioned, indicating a shift from just looking to the West for models of change.

Thus international influences were important in India in influencing changes to the economy and influencing changes to the Companies Bill including the accounting provisions in the Bill. International practice in corporate law and accounting were reviewed when drafting Indian legislation including accounting regulations as appropriate. However, international practice, although considered, was not always adopted in India. This is seen in the accounting

provisions included in the Companies Bill 1997. For example, the provisions relating to the National Advisory Committee on Accounting Standards by the Government is more in line with the social and political context of India rather than modelled along the lines of accounting standard setting bodies in the UK or USA, countries which have traditionally influenced India in the past.

The Reaction Phase

In the diffusion phase of the promulgation of the Companies Bill 1997, a Working Group was set up to draft the Bill which was then amended after public debate. The revised Companies Bill 1997 was introduced into Parliament in August 1997 and referred to the Finance Standing Committee for review. The Finance Standing Committee had not reported back to Parliament by October 1998 and it seemed unlikely that progress on the Companies Bill 1997 would be made in the foreseeable future. This was mainly due to delays in parliamentary business created by the unstable and uncertain political situation in India in the 1990's. *(Chapter 4)*

The DCA and the Government considered strongly that the revision of the Companies Act 1956 was important for the growth of the corporate sector and the economy. They therefore decided to promulgate some of the provisions included in the bill through a presidential ordinance as allowed by the constitution of India. The DCA issued the ordinance, the Companies (Amendment) Ordinance 1998 on 31st October 1998 in the official gazette of India.

Both intra-system activity (activity between the regulatory institutions within the accounting system) and trans-system activity (activity between social systems neighbouring the accounting system and the accounting system) are seen in the initial reaction phase of the promulgation of the Companies (Amendment) Ordinance 1988 and are discussed below.

Intra-system Activity

Interactions between the Department of Company Affairs and accounting regulation in the Companies Act 1956

The Government, represented by the DCA, were very concerned over the delay in the promulgation of the Companies bill 1997, which was due to the uncertain political situation. Despite several elections in a relatively short space of time in the late 1990's, no single political party had been able to achieve a majority in their own right. Hence coalitions were formed to create governments and such coalitions did not lead to stability or the ability of Government to complete legislative programs.

This political instability also delayed the promulgation of the Companies Bill 1997. In October 1998, the Finance Standing Committee still had to complete its review of the Companies Bill 1997. After this review the Bill would have had to be debated in both Houses of Parliament before it could receive presidential assent. It therefore appeared unlikely that the Companies Bill 1997 would be promulgated in the foreseeable future. Hence the DCA decided to use powers available in the constitution which allowed ordinances to be issued by the President to promulgate, what were in their opinion, key regulations which were needed immediately. Thus on 31st October 1998, the DCA issued the Companies (Amendment) Ordinance 1998. *(interviews with senior government officials on 10th November 1998 and 17th November 1998)*

The Companies (Amendment) Ordinance 1998 included :

- reducing the regulations on buy back of shares by companies. *(Clause 4 of the Companies (Amendment) Ordinance 1988)*
- giving companies the power to issue sweat equities (equities issued at a discount or for non-cash consideration. *(Clause 5 of the Companies (Amendment) Ordinance 1988)*
- introducing provisions on the nomination and transmission of shares. *(Clause 7 of the Companies (Amendment) Ordinance 1988)*
- introducing provisions on the establishment of a fund for investor education and protection. *(Clause 10 of the Companies (Amendment) Ordinance 1988)*

- introducing provisions on the constitution of a National Advisory Committee on Accounting Standards. *(Clause 11 of the Companies (Amendment) Ordinance 1988)*

- introducing some legal backing to accounting standards. *(Clause 12 of the Companies (Amendment) Ordinance 1988)*

- reducing the regulations on loans made by companies to their directors. *(Clauses 13 and 14 of the Companies (Amendment) Ordinance 1988)*

- reducing the regulations on inter-corporate investments. *(Clause 16 of the Companies (Amendment) Ordinance 1988)*

The DCA were therefore very influential in the reaction phase of the change. They decided which of the regulations in the Companies Bill 1997 were the most important and needed to be included in the Companies (Amendment) Ordinance 1998. They then instigated the promulgation of the Companies (Amendment) Ordinance 1988 using special presidential powers available in the constitution of India. *(interviews with senior government officials on 10th November 1998 and 17th November 1998)*

Interactions between the accounting profession and accounting regulation in the Companies Act 1956

The Institute of Chartered Accountants of India

The ICAI had very mixed feelings about the promulgation of the Companies (Amendment) Ordinance 1998. They supported the relaxation of the regulations on buy back of shares and inter-corporate loans and investments which affected their corporate clients. In relation to the accounting provisions, they welcomed the legal support for accounting standards and the fact that companies would have to follow accounting standards issued by the ICAI or make appropriate disclosures if they did not.

However, they were very concerned about the setting up of a National Advisory Committee on Accounting Standards as outlined in the diffusion phase. Despite the ICAI's representations against the setting up of such a committee, the Government were of the view that, as accounting standard setting was an

important tool for economic development, it should be in the hands of a government body which represented the wider interest group. The Government's view was upheld and the accounting profession were unable to prevent the promulgation of the provisions on the National Advisory Committee, despite the many representations made by the ICAI in the diffusion phase. The ICAI therefore were not influential in the initial stages of the reaction phase and were unable to stop or delay the promulgation of the Companies (Amendment) Ordinance 1998. *(interviews with senior government officials on 10th November 1998 and 17th November 1998)*

The other professional accounting bodies, the ICWAI and the ICSI were not affected by the promulgation of the Companies (Amendment) Ordinance 1998.

Trans-system Activity

Interactions between Parliament and accounting regulation in the Companies Act 1956

In the reaction phase to the promulgation of the Companies Bill 1997, some of the key provisions of the Companies Bill 1997 were promulgated in the Companies (Amendment) Ordinance 1998. The Ordinance was issued by the President of India, at the instigation of the DCA, using powers given to the President under the constitution of India. Parliament was not involved in the promulgation of the Ordinance.

However, Parliament did have the opportunity to amend and influence the Ordinance since it had to be ratified by Parliament within six months of being issued. If Parliament did not ratify the Ordinance, it would lapse. Thus if enough Members of Parliament were not in favour of the provisions of the Ordinance, then it would not be ratified and would lapse. The provisions of the ordinance were incorporated into the Companies (Amendment) Bill 1988 for ratification by Parliament. Before the Companies (Amendment) Bill 1998 could be ratified by Parliament, the Government, led by the BJP, lost a vote of confidence and elections were called, which were held in October 1999. This

left the Companies (Amendment) Bill 1998, which would have ratified the Companies (Ordinance) 1998 pending approval from Parliament. The provisions of the ordinance were later included in the Companies Bill 1999 and promulgated, using the parliamentary system in 1999. *(interview with senior government officials on 10th November 1998 and 17th November 1998; Bhaumik S.N., 17th May 1999; Editorial, India Today, 9th November 1999; department of company affairs, 1999)*

Interactions between the Corporate Sector and accounting regulation in the Companies Act 1956

The initial reaction of the corporate sector to the promulgation of the Ordinance was generally positive especially the reduction of regulations on buy back of shares and inter-corporate investments which they considered to be important for their competitiveness. Concern had been expressed by the corporate sector that the delays to the Companies Bill 1997 was adversely affecting Indian businesses especially in the areas of buy back of shares and inter-corporate investments and loans. *(Interviews with senior accounting personnel in companies on 27th October 1998, 29th October 1998, 2nd November 1998 and 5th November 1998)*

Some members of the corporate sector also showed concern at the extra layer of bureaucracy that was introduced with the National Advisory Committee though much less than the accounting profession. However, even this was not considered to be too onerous as the corporate sector already had to follow accounting standards, albeit issued by the accounting profession. Indeed the benefits of the Companies (Amendment) Ordinance 1988 for the corporate sector far outweighed any concerns they had about the Ordinance since most of the provisions were in line with the wishes and expectations of the corporate sector. *(Interviews with senior accounting personnel in companies on 27th October 1998, 29th October 1998, 2nd November 1998 and 5th November 1998)*

Interactions between the capital markets and accounting regulation in the Companies Act 1956

The capital markets i.e. SEBI and the Stock exchanges too were generally supportive of the provisions included in the Companies (Amendment) Ordinance 1998. They supported the relaxation in the regulations on buy back of shares and inter-corporate investments on the corporate sector which they felt would help the competitiveness of Indian companies.

The Companies (Amendment) Ordinance also gave SEBI the role of drafting the detailed rules on buy back of shares and on inter-corporate investments which increased the regulatory role of SEBI.

In addition the stock exchanges were supportive of the provisions of the Ordinance as they hoped that the relaxation in the regulations would stimulate the stock markets and increase the activity in the capital markets which had not been very buoyant in the late 1990's. *(interviews with senior officials of the stock exchanges and SEBI on 2nd November 1998, 5th November 1998 and 6th November 1998)*

Culture and Social Context

As in the other changes to the Companies Act 1956, it can be seen that culture and social context played an important part in all the three phases of the promulgation of the Companies Bill 1997.

Culture and social context were important in the source phase of the change in determining the problems that needed to be tackled and the objectives of the legislation. The problems that needed to be tackled came from the economic and social environment of India. As ever in India, the main objective was rapid economic development and changes to the Companies Act, including accounting changes, were made to help achieve this objective. In the previous changes to the Companies Act discussed in chapters 6 to 8, the objectives had been to increase economic development alongside social development through a planned economy and controls over the corporate sector. In the 1990's the means of

promoting economic development was now liberalisation of the economy and a reduction in the controls and bureaucracy faced by the corporate sector.

The importance of culture and social context was also seen in the diffusion and reaction phases of the change. As with the other changes to the Companies Act discussed in the previous chapters, culture and social context determined the regulatory modes, processes and institutions used to promulgate the regulatory changes as well as determining the problems that needed to be regulated.

In India, the Companies Act promulgated through the parliamentary system was again chosen as the best means for promulgating regulatory changes including changes to accounting regulations. This is very much expected in a country with the cultural characteristics of India.

The process for promulgating the Companies Bill 1997 was again along the same lines as for promulgation of previous amendment bills to the Companies Act 1956 but with a few differences. These can be traced to the different social and economic environment in India after liberalisation in 1991. The promulgation of the Companies bill 1997 started with the setting up of a Working Group to review the Companies Act 1956. This Working Group was mainly made up of professionals who had an interest in the Companies Act and included representatives from companies and the accounting profession but only one bureaucrat, a senior official of the DCA. *This was in line with the move towards* companies being run in a more professional manner by qualified professionals rather than being predominantly family run. The composition of the Working Group also reflected the view that Government was to be less involved in the regulation of the corporate sector especially in companies where there was not a strong public interest.

In addition, the changing economic and business environment meant that there was a move away from the perception, held since independence, that companies needed to be controlled by the Government and by legislation. The view that had been held was that many companies had been run only in the interests of management and sometimes run dishonestly. Companies therefore needed to be

controlled so that they operated in the national economic interest and for the benefit of shareholders and employees too, and not just in the interests of the managers. This perception had changed with the new economic environment and the new perception was that companies should be regulated less and allowed to compete more freely in the market place, especially where there was not a strong public interest i.e. in family managed private companies.

This was seen in the Companies Bill with many regulations over the corporate sector being relaxed. However, the reduction in the regulations over the corporate sector was far from complete. The Companies Bill 1997 still contained many regulations over the corporate sector and retained strong Government controls over the corporate sector. Liberalisation did occur and a reduction in the regulations that companies had to follow was seen. But, as expected with the culture and social context of India, a strong regulatory framework with strong Government involvement in regulating the corporate sector, including strong accounting requirements still remained.

The new Bill that was proposed still contained strong regulations with Government retaining control over the corporate sector. Government control is expected in all social systems in India and this included the accounting system. Strong statutory control of accounting is still seen in India with a Companies Bill where, although there is some relaxation of regulations, strong regulatory powers are still retained by the Government. For example

- statutory auditing requirements retained. *(Sections 180 to 188 of the Companies Bill 1997, August 1997)*
- cost accounting and auditing requirements retained. *(Section 189 of the Companies Bill 1997, August 1997)*
- Increased disclosures, for example
    - leased assets. *(Section 166 and Schedule I of the Companies Bill 1997, May 1997)*
    - foreign exchange transactions. *(Section 166 and Schedule I of the Companies Bill 1997, May 1997)*
    - debt exposure. *(Section 166 and Schedule I of the Companies Bill 1997, May 1997)*

- the introduction of a National Advisory Committee on Accounting Standards. *(Section 415 of the Companies Bill 1997, August 1997)*

- the introduction of Director of Investigation and Inspection. *(Sections 402 to 406 of the Companies Bill 1997, May 1997)*

- establishing a quasi independent tribunal, called the Company Law tribunal to help enforce the Companies Act. *(Sections 417 to 423 of the Companies Bill 1997, August 1997)*

- giving powers to the Government to appoint Company Prosecutors for conducting prosecutions arising out of the Companies Act. *(Section 433 of the Companies Bill 199, August 1997)*

When there were delays in the promulgation of the Companies Bill, the Government decided to promulgate what they perceived to be the most important regulations in an ordinance, the Companies (Amendment) Ordinance 1998 using presidential powers available in the constitution of India. Thus, as expected, Government took a strong, active role in the promulgation of key regulations including accounting regulations, as expected in a country with a culture such as India. Indeed, the accounting regulations that were promulgated gave some legal backing to accounting standards and increased the control of accounting standards by Government. This was despite the criticisms of these provisions by the accounting profession, in particular the ICAI who were most affected by the changes.

Thus in line with liberalisation some reduction in the regulations that companies had to follow was seen. However, despite liberalisation, the Government also retained or introduced new regulatory powers over the corporate sector, especially in accounting, in the Companies Bill 1997 as expected, and consistent, with the culture and social context of India.

Politics and Accounting Change

As indicated in the analysis of the attempt to promulgate the Companies Bill 1997, the process of promulgating accounting regulations is very political in many ways.

First of all, accounting is political in the sense that major accounting regulations have been included in the Companies Act which has always been promulgated through the parliamentary system and hence has been influenced and affected by Parliament. Had the Companies Bill 1997 progressed through Parliament, Parliament would have had the opportunity to influence its provisions.

Accounting is also political in the sense that there is strong Government involvement in accounting through the DCA. Indeed, this is seen to be becoming more, rather than less, important. For example, the introduction of the National Advisory Committee, the appointment of a Director of Inspection and Investigation and legal backing for accounting standards in the Companies Bill 1997 all indicate that there is stronger government control over accounting than before.

In addition, the whole process of promulgating accounting regulations can also be seen as the outcome of debate, representations and negotiation between the different parties interested in the Companies Act and in accounting regulation. This is done mainly within the parliamentary system or within Government initiated reviews of the Companies Act.

In this change to the Companies Act, the most influential parties appear to be companies and the Government. Companies were influential in starting the process of changing the Companies Act and in influencing the provisions of the Bill. Many provisions were included in the Companies Bill 1997 which relaxed the regulations that the companies had to follow and increased the flexibility with which they could operate. Indeed, in the reaction phase, the ordinance contained two major provisions reducing government control and restrictions in areas in which companies felt strongly that they needed more flexibility i.e. buy back of shares and inter-company loans and investments.

The Government, the DCA, is seen as less directly influential than in previous changes to the Companies Act. Unlike in previous amendments to the Companies Act 1956, they did not draft the Bill which was instead drafted by the

Working Group. The DCA did have some direct influence in the Working Group since one member of the Working Group was from the DCA. However, the DCA also retained strong indirect influence over the Companies Bill 1997 as they were consulted by the Working Group, they interacted with and made submissions to the Working Group and were able to introduce provisions into the Companies bill 1997. For example, the setting up of the National Advisory Committee on Accounting Standards, before it was introduced in Parliament. *(interviews with senior officials of the government on 10th November 1998 and 17th November 1998)*

Finally, the direct importance of the political context of India on the promulgation of the Companies Act can also be seen in the failure to promulgate the Companies Bill 1997. This can be traced primarily to the political situation of India and the lack of stable and strong Government. Despite several elections in the late 1990's, no political party gained a majority and thus coalition Government which has been weak and not terribly stable has led to delays in the business of Government and has caused delays in legislation including delays to the Companies Bill 1997.

Summary and Conclusion

As proposed in the theoretical framework outlined in chapter 3, the attempt to promulgate the Companies Bill 1997 can be broken down into three phases, a source phase, a diffusion phase and a reaction phase. Changes to the accounting system in the source phase are initiated by events and institutions outside the accounting system, in this case, changes are initiated by the Government due to concerns of economic growth in a liberalised and competitive economy.

The diffusion and reaction phase of the change are composed of intra-system activity and trans-system activity. The main intra-system activity occurred between the Government and accounting regulation and the accounting profession including the three professional accounting bodies, the ICAI, the ICWAI and the ICSI and accounting regulation in both the diffusion and reaction phases of the change. The main trans-system activity occurred between the

parliamentary system, the corporate sector and the capital markets and accounting regulation, again in both the diffusion and reaction phases of the change.

Once again, it is seen that culture and social context is important in all three phases of the change and the whole process of change, including accounting change, is surrounded by political processes. In the source phase, changes to the Companies Act, including accounting changes are initiated for economic reasons and not for technical reasons of what is "best" accounting policy. The economic and social context of the country determines the issues and problems which need to be tackled and also the institutions and processes used to tackle these issues and problems.

In the diffusion phase of the change, the Companies Act is retained as the primary means of regulating the corporate sector. But in the 1990's issues such as liberalisation and corporate governance are important issues which are considered in the revision of the Companies Act 1956. These issues are influenced by what is happening in the international community and indeed, are issues which are important in the UK and the USA, the countries which India most looks to when it looks for exemplars for change. However, alongside the liberalisation of some of the regulations, the Government still retained strong controls over the corporate sector, particularly in the area of accounting. This is very much in line with the social and cultural context of India.

Culture is also important in the reaction phase. When the Companies (Amendment) Bill 1997 was delayed, the DCA and the Government initiated the promulgation of the Companies (Amendment) Ordinance 1988 to promulgate important accounting and other regulations over the corporate sector. Again strong Government involvement is seen in the accounting system which is very much in line with the culture of India.

Accounting change is also seen to be political in many senses. Accounting change is influenced by Parliament and Government and is the result of interactions between the different parties interested in accounting. These parties

are identified as the Government, Parliament, the corporate sector, the accounting profession, the capital markets and the international system. All of these try and influence accounting change in both the diffusion and reaction phases of the change and the most successful are the Government and companies. The accounting profession, especially the ICAI are less successful in influencing accounting change to their benefit than in previous changes to accounting regulation in the Companies Act. In addition, the political context of India directly affects the process of regulatory change including changes to accounting regulations.

The Influence of Culture and Politics on Accounting Change in India from 1947 to 1998

by

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Chapter 10

The Institute of Chartered Accountants of India

Introduction

In India, there is strong control of accounting by statutory legislation. The Companies Act 1956 includes many regulations relating to accounting and these have been discussed in chapters 6 to 9. In addition to statutory legislation, there is a strong accounting profession in India. The Institute of Chartered Accountants of India (ICAI), which was set up in 1949, is the main professional accounting body involved in financial reporting and auditing. The ICAI regulates the training of chartered accountants and issues accounting standards to regulate financial reporting disclosure and measurement practices. As such, the ICAI is an important regulatory institution within the accounting system. (Chapter 5)

The two most important events in the history of the ICAI are the setting up of the Institute in 1949 and the constitution of the Accounting Standards Board by the ICAI to issue accounting standards in 1977. The setting up of the ICAI is analysed below and the accounting standard setting program of the ICAI is analysed in the chapter 11.

The setting up of the Institute of Chartered Accountants

The setting up of the ICAI can be broken down into broadly two periods, the diffusion phase from 1930 to 1949 and the initial reaction phase from 1949 to 1960.

The setting up of the ICAI in the period from 1930 to 1949

The ICAI was set up in 1949, soon after independence, under the Chartered Accountants Act 1949. However, the process to set up the Institute of Chartered Accountants of India can be traced back to 1930 and the setting up of the Indian Accountancy Board (IAB), which was one of the main institutions involved in the setting up of the ICAI.

Auditors in India had been required to register with local governments since 1913 and were known as registered accountants. In 1930, the British Government of India decided to centralise control over registered accountants and the Governor General in Council was given powers to maintain the register of accountants, which had been initiated in 1913. This was done through the Companies (Amendment) Bill 1930 which also gave the Government the power to constitute a body, known as the Indian Accountancy Board (IAB) and issue rules to regulate the IAB. The IAB was set up by the Government of India, using powers given to it under the Companies (Amendment) Bill 1930, in 1932. The role of the IAB was to advise the Governor General on all matters of administration relating to accountancy and auditing and to assist him in maintaining the standards of qualification and conduct of persons enrolled on the register of accountants. This included regulating the Government Diploma in Accounting (GDA) which was an accountancy qualification for Indian accountants set up in the 1920's. *(Kapadia G.P., 1972, Chapters 2 and 3)*

The IAB was set up in 1932 and continued in existence until 1949. The first two IAB's were appointed in 1932 and 1935 and were composed of entirely nominated members. The third, fourth and fifth IAB's were partly elected by registered accountants and partly nominated by the Government. The elected members of the IAB were, by and large, senior Indian accountants and the nominated members of the IAB were British accountants, representatives of industry and commerce and government officials. The nominated members were intended to redress any shortcomings in the balance of the IAB. For example it was expected that, despite carrying out 50% of the audit work in India, British accountants and British firms would not be elected on to the IAB due to

nationalism in the country in the 1930's and 1940's. It was considered appropriate by both the Government and the Indian accountants, that British accountants should be represented on the IAB and this was ensured through the nominated representatives on the IAB. *(Chakravorty D.K., 1994, pages 38-40 ; Kapadia G.P., 1972, Chapters 2 and 3)*

It was intended that the IAB would, in time, develop into an autonomous accounting profession in India, very much along the lines of the British model. This had not occurred by the time of independence. However, the IAB was to be instrumental in the development of the ICAI. At independence, the members of the IAB who were not government members, were keen for an autonomous institute to be set up quickly but the Government was more cautious and decided to consider carefully the possibility of setting up an accounting institute.

In response to this, the IAB canvassed support for their point of view and lobbied members of parliament, government ministers and senior government officials to argue their case for an independent accounting profession and institute. In 1948, the Government was finally persuaded by the arguments of the accounting profession that it was time for the accounting profession to assume responsibility for the maintenance of professional qualifications, discipline and conduct of accountants. However, the Government did not consider that complete independence was appropriate and stated that the accounting institute and profession, which would be set up, would be subject to some supervision by Government. *(Kapadia G.P., 1972, Chapters 2 and 3)*

After the Government accepted the argument for setting up an accounting institute, the Ministry of Commerce prepared a tentative scheme of autonomy for the accounting profession. This was circulated to all parties interested in accounting, which included provincial governments, chambers of commerce, the IAB and other associations of accountants for comment. After receiving comments on this scheme, the Ministry of Commerce requested the IAB to set up an expert committee, to examine the Ministry of Commerce's scheme for an autonomous accountancy body.

The expert committee of the IAB reviewed the scheme for autonomy prepared by the Ministry of Commerce and considered the feedback received by the Ministry on their scheme. During the review on the autonomy of the accounting profession by the expert committee of the IAB, there were frequent interactions and discussion between the expert committee and the Ministry of Commerce. The main issues that were discussed related to the name of the Institute and the question of reciprocity and recognition of foreign accounting regulations.

The expert committee prepared its report, which covered the setting up of the institute under a Council and the role of the institute, together with a draft chartered accountants Bill, and submitted this to the Government on 4th July 1948. The Ministry of Commerce reviewed the recommendations of the expert committee, prepared a summary of the IAB proposals for the setting up of an independent accountancy profession and circulated this to all other government departments. The Ministry of Commerce also indicated that they intended to implement the IAB proposals by sponsoring the necessary legislation in 1949.

At this stage, the proposals were opposed by the Central Bureau of Direct Taxes (CBDT) in the Department of Revenue, under the Ministry of Finance. The CBDT was unhappy that the council of the ICAI should have complete autonomy over disciplinary proceedings with regards to income tax matters. There was, therefore, direct conflict between the accounting profession who wanted the ICAI to have total autonomy and the Ministry of Finance who wanted control over the disciplinary process in cases which related to income tax matters.

The Ministry of Commerce considered both points of view and recommended that professional misconduct cases which related to income tax matters should be dealt with by the Ministry of Finance and the Government. This was included in the Chartered Accountants Bill which was introduced into Parliament on 4th September 1948 and referred to a select committee of both houses of parliament on 1st February 1949. Apart from the provisions relating to the disciplinary process, the rest of the Bill was in line with the recommendations of the expert

committee of the IAB, which in turn had been based on the original scheme for an autonomous accounting profession prepared by the Ministry of Commerce. *(Kapadia G.P., 1972, Chapters 4 and 5)*

The Select Committee reviewed the Chartered Accountants Bill and took viewpoints from all parties interested in the bill. The opinions were mostly favourable and the Bill was widely supported by the Government, the accounting profession and the corporate sector. The only provision which the IAB did not support related to the disciplinary procedure of the ICAI.

Between September 1948 and March 1949, when the select committee completed its review of the Chartered Accountants Bill, meetings were held between the IAB, the Ministry of Finance and the Ministry of Commerce to try and resolve the disciplinary issue. These meetings finally led to a compromise proposal, which let the ICAI deal with all disciplinary procedures, subject to approval by the High Courts.

This compromise was acceptable to all parties and was put forward to the select committee for their approval. The select committee too accepted this compromise and stated that, in their opinion, an independent and impartial inquiry would be assured if the council of the ICAI would forward its findings to the High Courts for ratification. This process was similar to the disciplinary process for the legal profession under the Indian Bar Councils Act, 1926. *(Kapadia G.P., 1972, Chapters 4 and 5; Editorial, Chartered Accountant, vol i, November, 1952, pages 209-211)*

The disciplinary issue was the only major change made to the Chartered Accountants Bill at the select committee stage. The Chartered Accountants Bill, as amended by the Select Committee, was then debated by Parliament on 9th April 1949. The Bill was generally supported and had a fairly smooth passage through the parliamentary debates. This was mainly due to informal interactions between the expert committee of the IAB and the various ministries to sort out any issues of contention. The main changes made to the bill at the parliamentary debate stage related to the status of accountants who had obtained the GDA but

were not registered accountants and older accountants who had become auditors before the GDA was started and before registration of auditors was required. These were not major changes and the Chartered Accountants Bill received assent and became legislation on 1 May 1949. *(Kapadia G.P., 1972, Chapters 4 and 5; The Chartered Accountants Act 1949; Indian parliamentary debates on the Chartered Accountants Act on 9th April 1949)*

The activities of the ICAI from 1949 to 1960

The ICAI was set up within six months of the Chartered Accountants Act 1949 becoming law in May 1949. The Council of the ICAI was set up, with elected representatives from the membership of the ICAI and nominated representatives from the Government and chambers of commerce, in November 1949. The Council held its first meeting on 15th November 1949 and elected Mr G.P Kapadia, an important figure in the setting up of the ICAI, as the first president of the ICAI.

In the first years, the Council of the ICAI undertook the following:

- established a strong, competent secretariat.
- set up processes to deal with examinations, education, professional ethics and discipline.
- tried to make impact on the industrial and trading community, investing public, government authorities and public at large.

These activities were not affected by Government control and so, to a certain, extent the ICAI was able to act as an independent accounting professional institute. There were still interactions between the ICAI and the Government. Government officials were invited to attend key functions of the ICAI for example its annual conferences and the Ministries of Commerce and Finance were represented on the Council of the ICAI. But, on the whole, the ICAI was able to set up its functional structure and undertake its day to day activities with little interference from the Government. In the early years of the ICAI, there was much support for the ICAI and a lot of optimism that the ICAI would indeed

create an independent and ethical accounting profession from the Government, the corporate sector and other parties interested in accounting.

There were a few criticisms of the accounting profession. For example, some criticisms were made that chartered accountants were giving clean audit reports where they should not and some criticisms of the independence of the auditing profession. These criticisms were not widespread and the Government showed strong support for the ICAI whenever criticisms were made. *(Kapadia G.P., 1972, Chapter s 4 and 5; Editorial, Chartered Accountant, vol i, November, 1952, pages 209-21; Editorial, Chartered Accountant vol viii, May 1960, pages, 429 to 431)*

In addition to the above, the Government influenced the ICAI in the reaction phase to the setting up of the ICAI in two main areas. Two changes were made to the Chartered Accountants Act in the reaction phase, both of which were initiated by the Government. The first change took place in 1955 and related to the issue of reciprocity and recognition of foreign qualifications and is discussed below. The second change took place in 1960 and related to the setting up of another professional accounting body, the Institute of Cost and Works Accountants of India, and is discussed in Chapter 12.

Analysis of the setting up of the Institute of Chartered Accountants of India

The setting up of the ICAI can be broken down into source, diffusion and reaction phases, using the theoretical framework proposed in chapter 3. as follows:

The Source Phase

The ICAI was set up in 1949, very soon after independence. The ideal of an autonomous and independent profession was inherited from the British at independence in 1947, together with many other institutions such as the legal system and the parliamentary system. At independence, an autonomous

accountancy profession was not in existence. However, the groundwork for an independent profession, based on the UK model, had been put in place with the setting up of the Indian Accountancy Board (IAB). This Board had been set up in 1932 to advise the Government on all issues relating to accounting and auditing. These included

- regulating the accounting and auditing profession through a register of accountants on which all practising auditors had to register
- regulating the Government Diploma in Accounting (GDA), a professional accounting qualification for Indian accountants, which had been set up in the 1920's.

The IAB contained British accountants, Indian accountants and government representatives. After independence, the Indian accountants on the IAB argued strongly for an independent, autonomous accounting institute and profession, very much along the line of the ICAEW in the UK. *(Chakravorty D.K., 1994, pages 38-40; Kapadia G.P., 1972, Chapter s 2 and 3; Interviews with senior representatives of the accounting profession on 3rd November 1998, 4th November 1998 and 18th November 1998)*

The senior accountants on the IAB made their views known to the government representatives on the IAB but no immediate action took place. Instead, the Government stated that they would take their time in deciding on whether to set up an independent institute. The members of the IAB continued to argue their case to members of parliament, government ministers and government officials and in 1948 persuaded the Government to allow the setting up of an independent accounting profession, headed by an autonomous professional accounting institute.

The accounting profession, represented by the IAB was, therefore, instrumental in changing the accounting system but were not able to do this without the authorisation and approval of the Government. The Ministry of Commerce had to be persuaded by the IAB that an independent accounting profession was important. One of the main reasons that persuaded the Government to support an autonomous accounting profession came from outside the accounting system. This was the perception in the Government, that accounting was an important

tool for economic development and that accountancy had a pivotal role to play in economic development. *(Kapadia G.P., 1972, Chapter 4; interviews with senior government officials on 10th and 17th November 1998)*

The change to the accounting system was therefore initiated by the accounting profession but only progressed due to institutions outside the accounting profession and for reasons which originated from outside the accounting system. In this case the Ministry of Commerce was important in the development of the ICAI since they considered that the ICAI and accounting was important for economic development. The accounting profession, represented by the IAB, wanted a completely autonomous accounting profession, very similar to the ICAEW in the UK. However, the UK model was not followed completely and a statutory accounting profession, more in line with the social, cultural and political context of India was developed. This is discussed below, in the diffusion phase.

The Diffusion Phase

In the diffusion phase of the change, the ICAI was set up under the Chartered Accountants Act 1949. Both intra-system activity (activity between the regulatory institutions within the accounting system) and trans-system activity (activity between social systems neighboring the accounting system and the accounting system itself) is seen in the diffusion phase of the change. Intra-system activity is seen between the Government and professional accounting regulation and the IAB and professional accounting regulation. Trans-system activity is seen between the parliamentary system and professional accounting regulation, the Ministry of Finance and professional accounting regulation and the international system and professional accounting regulation. Both intra-system activity and trans-system activity are discussed below.

Intra-system Activity

Interactions between the Government and the Institute of Chartered Accountants of India

The Ministry of Commerce was directly involved in the setting up of the accounting profession in India at independence. The accounting profession, as represented by the IAB, put forward the proposal of an independent accounting profession headed by a completely autonomous accounting profession. But they were informed by the chairman of the IAB, one of the Government representatives on the Board, that the Government would not be forced to make any early decisions on the future of the accounting profession.

The Government considered the idea of an independent accounting profession from independence in 1947 until early 1948. During this time they met with representatives of the accounting profession and other parties interested in accounting to discuss the issue of an autonomous accounting profession. After due consideration, the Ministry of Commerce finally accepted that an accounting profession with some independence was appropriate. However, they stated that such an institute could not have complete autonomy since accounting was an important tool for economic and social development and affected everyone, not just accountants. In addition, a completely independent accounting profession was not consistent with the culture and social context of India, which indicates that strong government involvement in accounting is expected in addition to regulation by an accounting profession. *(Kapadia G.P., 1972, Chapter 4; Chapter 5)*

In 1948, the Ministry of Commerce prepared a memorandum on the setting up of a statutory accounting profession headed by a professional accounting institute. The Institute was to be set up under a parliamentary charter using statutory legislation and would be headed by a council containing members of the accounting profession, government representatives and representatives of the corporate sector. This memorandum was circulated to all parties interested in accounting, including all government departments, the accounting profession and the corporate sector. Thus the Government took the initiative in the setting up of

the accounting profession very early on and dictated the terms on which the accounting profession would be set up.

The Ministry of Commerce then requested feedback on their ideas. In particular, they requested feedback on issues such as what the name of the institute should be and whether foreign qualifications should be recognised. *(Kapadia G.P., 1972, Chapter 4)*

The IAB had suggested that the name of the Institute might be "The Institute of Chartered Accountants of India". The Ministry of Commerce was concerned about using the name "chartered accountant". They argued that this might cause some problems with the British accounting profession, since the name might be deemed to be too similar to that of the ICAEW in the UK. In addition, some Indian accountants who had travelled to the UK and qualified with the ICAEW raised some objections to the use of the term "chartered accountant". These accountants argued that this might cause some confusion in the corporate sector, as to which institute accountants had qualified with. The British qualified accountants wished to be distinguished from accountants qualified in India as they expected that they would have higher status and hence gain more work than Indian qualified accountants. *(Kapadia G.P., 1972, Chapter 5; interviews with senior representatives of the accounting profession on 3rd November 1998, 4th November 1998 and 18th November 1998)*

In relation to the issue of reciprocity, the IAB had indicated that they wished to recognise foreign qualifications and foreign institutes on a mutual recognition basis. The Ministry of Commerce was unsure whether recognition would be given to the Indian institute by the British accounting profession and the Board of Trade in the UK and did not want the Indian institute to withdraw recognition for British qualifications. This was due to concerns that if the ICAI stopped recognising British accounting qualifications, goodwill between the Indian Government and the British authorities might be lost and hence the negotiating position of the Government on other issues weakened. *(Kapadia G.P., 1972, Chapter 4; interviews with senior representatives of the accounting profession on 3rd November 1998, 4th November 1998 and 18th November 1998)*

After receiving feedback on their memorandum, the Ministry of Commerce decided to set up an expert committee to review the setting up of a statutory accounting profession. They did not set up the expert committee themselves. Instead, they asked the IAB to set up the expert committee, which they would approve. The expert committee was set up on 1st May 1948 and approved by the Ministry of Commerce on 13th May 1948.

The Ministry of commerce set the terms of reference for the expert committee which was to:

- to examine the tentative scheme for an autonomous association of accountants in India, proposed by the Ministry of Commerce.
- to indicate whether the institute could be set up by amendments to existing laws or whether new legislation was necessary

The expert committee set up by the IAB reviewed the scheme for autonomy proposed by the Ministry of Commerce from May 1948 to July 1948 and reported back to government with the following recommendations:

- a professional accounting institute, called the ICAI, should be set up by a special act of parliament, called the Chartered Accountants Act.
- the members of the institute would initially be the registered accountants, renamed as chartered accountants.
- the role of the ICAI would be to set examinations for membership to the ICAI, regulate the training of its members, regulate certificates of practice given to its members and exercise disciplinary procedures over its members.
- the affairs of the ICAI should be managed by a Council consisting of fifteen elected representatives, one nominated representative of the corporate sector and three nominated representatives of central government.
- the council of the ICAI and the accounting profession should be completely autonomous, free from control from the central government, except in a small number of matters which would be agreed and specified in the Chartered Accountants Act.
- the council of the ICAI should have the power to recognise foreign qualifications, usually on a reciprocal basis, if it was satisfied that such recognition was in the interests of the country and of the profession.

The expert committee also submitted a draft Chartered Accountants Bill to the Ministry of Commerce, under which the ICAI could be set up. *(Kapadia G.P., 1972, Chapters 4; The Chartered Accountant Act 1949; interviews with senior representatives of the accounting profession on 3rd November 1998, 4th November 1998 and 18th November 1998)*

During the review of the autonomy of the accounting profession by the expert committee, the expert committee and the Ministry of Commerce were in frequent contact and discussed, informally, the proposals which the expert committee was considering. Thus, the Ministry of Commerce exerted significant indirect influence over the recommendations made by the expert committee, particularly on the issue of reciprocity and recognition of foreign qualifications. They persuaded the ICAI to accept recognition of British qualifications without definitively stating that recognition of British and other foreign accounting bodies would be strictly on a mutual recognition basis. Thus, the report that was finally submitted by the expert committee was heavily influenced by the Ministry of Commerce. *(Kapadia G.P., 1972, Chapter 4; Editorial, Chartered Accountant, vol viii, May 1960, pages, 429 to 431)*

Not all of the Ministry of Commerce's suggestions were accepted by the expert committee. For example, the Ministry of Commerce was reluctant to call the Institute, the Institute of Chartered Accountants of India and would have preferred a different term such as "registered accountant" but the expert committee argued successfully that the most appropriate name was indeed the Institute of Chartered Accountants of India. *(Kapadia G.P., 1972, Chapter 5; Editorial, Chartered Accountant, vol viii, May 1960, pages, 429 to 431)*

The Ministry of Commerce reviewed the report of the expert committee and approved the recommendations included in the report. They then prepared a circular on the proposals to set up the ICAI and circulated this to all government departments.

At this stage the Ministry of Finance raised objections to the proposals due to recommendations on the disciplinary process. The Ministry of Finance was unhappy that the ICAI would deal with disciplinary cases relating to income tax

matters. These objections are discussed in more detail under trans-system activity.

The Ministry of Commerce considered the viewpoints of both the IAB and the Ministry of Finance, before drafting the Chartered Accountants Bill. This Bill included most of the recommendations made by the expert committee of the IAB with the exception of their recommendations on the disciplinary process. On this issue, the Ministry of Commerce accepted the Ministry of Finance's suggestions and gave the CBDT and the Ministry of Finance powers to deal with disciplinary matters that related to income tax. *(Kapadia G.P., 1972, Chapter 4)*

The Chartered Accountants Bill was introduced into Parliament on 1 September 1948 and was referred to a select committee for review on 1 February 1949 by the Ministry of Commerce. Between the introduction of the bill into Parliament and the end of the select committee review of the Bill, meetings were held between the Ministry of Commerce, the Ministry of Finance and Mr GP Kapadia, a senior member of the IAB, to try and resolve the conflict on the issue of the disciplinary procedure. The accounting profession considered that control over disciplinary matters by the Ministry of Finance was unacceptable and the Ministry of Finance considered that ICAI control over income tax cases was unacceptable. The meetings and negotiations led to the following compromise:

- all disciplinary cases would be dealt with by the council of the ICAI, through its disciplinary committee.
- the CBDT would be represented on the council of ICAI and would be able to monitor the decisions of the council.
- the decisions and recommendations of the disciplinary committee and the council of the ICAI would be forwarded to the high court for approval in all cases which related to income tax or which related to the public interest.

This compromise was acceptable to all parties. *(Kapadia G.P., 1972, Chapter 4; The Chartered Accountants Act 1949)*

The Bill was then promulgated through the parliamentary system and became law on 1st May 1949, with very little further criticism. Only minor changes were

proposed to the Chartered Accountants Bill in the parliamentary debates on the Bill. The ICAI was set up very quickly after this and the Ministry of Commerce continued to be influential in the activities of the ICAI after it was set up since it was a member of the Council of the Institute. *(Kapadia G.P., 1972, Chapter 4; The Chartered Accountants Act 1949; Indian parliamentary debates on the Chartered Accountants Act on 9th April 1949)*

From the above it can be seen that the Government, via the Ministry of Commerce, was very important in the setting up of the ICAI. Without the approval of the Ministry of Commerce, the ICAI would not have been set up. The Ministry of Commerce prepared the first tentative scheme for setting up the statutory accounting profession and institute and circulated this to all parties interested in the accounting profession. The Institute that was finally set up was based on this scheme. The Ministry of Commerce initiated the setting of the expert committee by the IAB and approved the members of the expert committee and set its terms of reference.

After the expert committee reported back to the Ministry of Commerce, the Ministry of Commerce approved the recommendations of the expert committee of the IAB and circulated a summary of the recommendations to all government departments. They then held meetings with the IAB and the Ministry of Finance to discuss the objections that the Ministry of Finance had with the proposed disciplinary process. After taking into account both views, the Ministry of Commerce drafted the Chartered Accountants Bill, which was introduced into Parliament on 1 September 1948, and steered the Bill through the parliamentary process. This included holding meetings to try and resolve the disagreement on the disciplinary procedure which still existed. These meetings finally resulted in a compromise disciplinary procedure acceptable to both the Ministry of Finance and the IAB. Thus the Ministry of Commerce was an important mediator between the accounting profession and the Ministry of Finance.

Once the Chartered Accountants Bill 1949 was passed by parliament, the Ministry of Commerce continued to influence the accounting profession and the

Institute since it was represented on the Council of the Institute, which ran the ICAI.

The accounting profession and the Institute of Chartered Accountants of India

The accounting profession in India at independence played a very important role in the setting up of the ICAI in India.

Before independence, the IAB had been set up by the British Government in India, with the intention that this would, in time, develop into an autonomous and independent accounting institute, along the lines of the ICAEW in the UK. At independence, the senior Indian accountants on the IAB were keen to see an independent accounting profession and worked actively to achieve this. They proposed to the chairperson of the IAB, a representative of the Government, that it was time to set up an independent accounting profession and that this should be done as quickly as possible. The Government were not persuaded immediately and informed the IAB that they would consider their suggestions.

Over the next few months, members of the IAB met with members of the government, senior officials of various government departments and members of parliament and argued strongly for an independent accounting profession. These representations were successful and early in 1948, the Ministry of Commerce agreed, in principle, to the setting up of an accounting profession and institute, in line with the wishes of the IAB. However, they clarified that the ICAI would not be totally independent. It would be set up under an act of parliament and there would be some government involvement in the institute. *(Kapadia G.P., 1972, Chapter 4; interviews with senior representatives of the accounting profession on 3rd November 1998, 4th November 1998 and 18th November 1998)*

Once the Ministry of Commerce accepted the need for a statutory accounting profession, they prepared a tentative scheme for the setting up of the accounting profession and circulated this widely. They then asked the IAB to set up an

expert committee to review their scheme and to indicate whether separate legislation was necessary to set up the accounting institute.

During their review of the Ministry of Commerce's proposals for the setting up of the accounting profession, the expert committee of the IAB made a detailed study of the constitution and working of foreign autonomous associations of accountants outside India. In particular, they studied the workings of the ICAEW in the UK and the Society of Certified Public Accountants of New York. They also reviewed the feedback received in response to the Ministry of Commerce's scheme and also interacted with the Ministry of Commerce on the proposals that were included in their report. *(Kapadia G.P., 1972, Chapter 4; interviews with senior representatives of the accounting profession on 3rd November 1998, 4th November 1998 and 18th November 1998)*

The expert committee of the IAB presented their report, including a first draft of the Chartered Accountants Bill, back to the main committee of the IAB in July 1948. In their meeting on 5th July 1948, the main committee of the IAB considered the report of the expert committee and the draft bill prepared by the expert committee. The IAB accepted the proposals made by the expert committee and submitted the report and the draft bill to the Ministry of Commerce, in July 1948.

The main proposals of the report are outlined in the previous section. There were two main differences between the recommendations of the expert committee of the IAB and the Ministry of Commerce. The first related to the name of the institute. The Ministry of Commerce was reluctant to use the title "chartered accountant" due to any possible confusion that might occur with the ICAEW. The IAB was able to successfully argue that the name "Institute of Chartered Accountants of India" was appropriate and that no confusion would arise with this name. *(Kapadia G.P.,1972, Chapter 5)*

The second issue was the issue of reciprocity and recognition of foreign qualifications. The IAB wished to recognise foreign accounting qualifications and professional accounting bodies if there was mutual recognition of the IACI.

On this issue, the Ministry of Commerce was able to influence the IAB's proposals so that the condition of mutual recognition was dropped.

(Kapadia G.P., 1972, Chapter 4; The Chartered Accountant, vol viii, May 1960, pages, 429 to 431)

The Ministry of Commerce reviewed the report and draft bill prepared by the expert committee of the IAB, accepted its proposals and circulated a summary of its proposals to all government departments. At this stage, the CBDT raised objections to the proposals made by the IAB on the disciplinary process of the ICAI. These objections are given below, under trans-system activity.

When the CBDT in the Ministry of Finance raised objections to the proposals relating to disciplinary matters, Mr G.P. Kapadia, a senior member of the IAB met with the Ministry of Commerce, the CBDT and the Ministry of Finance to try and resolve the conflict. *(Kapadia G.P., 1972, Chapter 4)*

The IAB were particularly concerned about the Ministry of Finance objections. They wanted as independent an institute as possible which would deal with all matters relating to the institute, including all disciplinary proceedings and income tax related issues. This was particularly important since income tax work accounted for over 70% of the revenue of practising accountants. The IAB defended their proposals using the following arguments:

- autonomy was important for the profession. It was, therefore, not possible to accept government involvement in professional misconduct matters as this would seriously affect the standing and reputation of the profession.
- the Ministry of Finance had previously, informally, agreed to an autonomous profession and were now being unreasonable by withdrawing their agreement.
- other similar accounting professions in the world had similar powers to what the IAB were asking for and these were suitable models to follow. Particular reference was made to the accounting professions in the UK and USA.

(Kapadia G.P., 1972, Chapter 4)

Initially, the IAB was not successful in persuading the Ministry of Commerce to accept their views. Indeed, the Ministry of Commerce reviewed both sides of the argument and initially accepted the Ministry of Finance point of view. The Ministry of Commerce drafted the Chartered Accountants Bill, in line with most of the suggestions of the expert committee of the IAB, except for the issue of the disciplinary procedure. This was drafted in line with the wishes of the Ministry of Finance. The Chartered Accountants Bill was introduced into Parliament on 1 September 1948 and referred to a select committee of both houses of parliament on 1 February 1949.

The IAB and the accounting profession were unhappy with the disciplinary provisions in the Chartered Accountants Bill as they considered that the proposals:

- would undermine the independence and autonomy of the accounting profession and the Institute, which would govern the accounting profession.
- indicated a lack of trust in the accounting profession which would be detrimental to the interests of the accounting profession.

(Kapadia G.P., 1972, Chapter 4)

They, therefore, continued to hold meetings with both the Ministry of Commerce and the Ministry of Finance to try and persuade the Government to change these proposals. Meetings were held between Mr Kapadia, a senior member of the expert committee of the IAB (later the first president of the ICAI) and the Minister of Commerce and the chairman of the CBDT. These meetings were not successful.

It appeared that the Bill might not be promulgated as agreement could not be reached on the disciplinary issue. However, the negotiations continued and Mr Kapadia finally met with the Finance Minister and a compromise was reached. The Institute would be given powers to deal with all disciplinary issues, through its disciplinary committee. However, the disciplinary process would be monitored by government representatives on the Council of the Institute. In

addition, all disciplinary proceedings relating to income tax matters and other public interest matters would be subject to approval of the high courts who would be able to alter any penalties imposed by the Institute. The IAB were not fully happy with this compromise but accepted that it was probably the best that they could hope to achieve at this point in time.

The Bill then passed through the select committee review and the parliamentary debates with little further change. The only changes made were to protect the rights of accountants who had obtained the GDA qualifications before independence but were not registered accountants and auditors who had been given the right to undertake audits before registration of auditors was required. These were not major changes to the Bill and the Bill was given parliamentary assent and became law on 1 May 1949. The Chartered Accountants Act 1949 created a statutory accounting profession and accounting institute in India. *(Kapadia G.P., 1972, Chapter 4; Indian parliamentary debates on the Chartered Accountants Act on 9th April 1949)*

The Institute of Chartered Accountants of India came into existence in November 1949, in line with the provisions of the Chartered Accountants Bill 1949. The Institute was headed by a Council. The membership of the council included accountants who were elected, government representatives, including senior officials of the Ministry of Commerce and the CBDT from the Ministry of Finance and members of chambers of commerce which represented the corporate sector. The Council was headed by a president who was chosen from the elected members of the council and was, usually, a senior accountant from the larger auditing firms in India. *(Kapadia G.P., 1972, Chapters 4 and 5; The Chartered Accountants Act 1949; interviews with senior representatives of the accounting profession on 3rd November 1998, 4th November 1998 and 18th November 1998)*

From the above it can be seen that the accounting profession, in particular the IAB, was instrumental in the setting up of the ICAI and the accounting profession in India, soon after independence. The ICAI would not have been set up without the activities of the IAB. The IAB made the initial proposal to set up an independent accounting profession, along the lines of the UK accounting

profession, and persuaded the Government that such a profession and institute was both needed and appropriate. The IAB then set up an expert committee, at the request of the Ministry of Commerce, to review the Ministry of Commerce's plans for setting up the ICAI and to draft suitable legislation under which the ICAI would be set up.

The IAB submitted its report to the Ministry of Commerce, together with a preliminary draft of legislation under which the ICAI could be set up. The Ministry of Commerce drafted the Chartered Accountants Bill, in line with most of the recommendations of the report of the expert committee of the IAB. There was only one major exception and this was on the disciplinary process which the Ministry of Finance objected to.

When the Ministry of Finance raised objections to the proposals on disciplinary matters, a senior member of the IAB held meetings with senior Government officials in both the Ministry of Commerce and the Ministry of Finance to try and resolve the issue. The meeting resulted in a compromise proposal on the disciplinary process which was acceptable to both the IAB and the Ministry of Finance. The IAB, therefore, played an important role in resolving the conflict over the disciplinary process, together with the Ministry of Finance and the Ministry of Commerce.

The Bill that was finally passed, which enabled the ICAI to be set up as a statutory body, was based on the report of the expert committee of the IAB and was the result of negotiations between the IAB, the Ministry of Commerce and the Ministry of Finance. The setting up of the ICAI was therefore very much influenced by the IAB and the accounting profession in India at the time of independence.

Trans-system Activity

Interactions between Parliament and the Institute of Chartered Accountants of India

The ICAI was set up using statutory legislation, promulgated through the parliamentary system. In common with many changes to the accounting system, statutory legislation promulgated through the parliamentary system was chosen as the most appropriate means for changing the accounting system.

The ICAI was set up under the Chartered Accountants Act 1949, which was drafted by the Ministry of Commerce, based on a report prepared by the expert committee of the IAB. This, in turn, was based on a scheme initially proposed by the Ministry of Commerce. The Chartered Accountants Bill was introduced into Parliament by the Ministry of Commerce on 1st September 1948. The Bill was then referred to a select committee for review on 1st February 1949. After the select committee review of the Bill, it was debated in both houses of parliament. Thus Parliament had the opportunity to influence the Bill at both the select committee stage and in parliamentary debates. *(Kapadia G.P., 1972, Chapter 4; The Chartered Accountants Act 1949; interviews with senior representatives of the accounting profession on 3rd November 1998, 4th November 1998 and 18th November ; Indian Parliamentary debates on the Chartered Accountants Act on 9th April 1949)*

The select committee reviewed the provisions of the Chartered Accountants Bill and discussed the contentious issues of the name of the institute which would be set up, reciprocity and the disciplinary procedure of the institute. The select committee accepted that the name of the institute should be the Institute of Chartered Accountants of India, in line with the wishes of the IAB and approved of the reciprocity provisions which were in line with the wishes of the Ministry of Commerce. The select committee also reviewed the disciplinary procedure of the institute. They reviewed both sides of the argument and the considered the compromise proposal reached by the IAB and the Ministry of Finance on the disciplinary process. This compromise process was approved of by the select committee. Had the select committee not considered the proposals appropriate,

they would have been able to make changes to the proposals. *(Kapadia G.P., 1972, Chapter 4)*

During the parliamentary debates, there was much support for the Chartered Accountants Bill and the only issues raised were in relation to how the ICAI would deal with the accountants who had qualified before independence or who had obtained the right to practise as auditors under rules in existence pre-independence but had not become registered accountants. These changes were not major changes. Indeed, the contentious issues had been discussed and resolved in meetings held between the IAB and the Government, outside the parliamentary system. *(Kapadia G.P., 1972, Chapter 4; Indian parliamentary debates on the Chartered Accountants Act on 9th April 1949)*

Apart from the issues discussed above, no other major changes to the Chartered Accountant Bill were made at either the select committee or the parliamentary debate stages of the parliamentary process. At this time in India, there was general support for setting up an accounting institute and a statutory accounting profession. Thus Parliament did not make any major changes to the Chartered Accountants Bill, except for approving amendments to the Bill on the disciplinary process.

Interactions between the Ministry of Finance and the ICAI

The Ministry of Finance played an important part in shaping one of the key roles of the ICAI, that of its disciplinary procedures. The IAB had proposed that the ICAI would have complete autonomy in its operations, including independence in its disciplinary process. The Central Bureau of Direct Taxes (CBDT) opposed these proposals. They were unhappy that the council should have complete autonomy to conduct disciplinary proceedings with regards to income tax matters since:

- other older professions with much older traditions and histories such as the legal profession were regulated by independent means. For example the legal profession was regulated by the courts and was not self-

regulating. They argued that it would be too much to expect a relatively new profession to correctly deal with disciplinary matters due to issues such as vested interests and independence.

- investigation of cases of professional misconduct in income tax matters by the Council of the ICAI might involve the Council in being given confidential information about assessees which was not desirable and against the Income Tax Act 1922.

(Kapadia, G.P., 1972, Chapter 4)

The Ministry of Finance also made some general arguments to tighten control over the accounting and auditing profession which included the following:

- the list of persons prevented from being chartered accountants should be expanded to include anyone who had been dismissed from public service and anyone upon whom a final order of penalty had been imposed, under the income tax laws
- the definition of audit and scope of audit needed to be more tightly defined so that auditor negligence could be more easily determined.
- auditors of private companies should possess the same qualifications as auditors of public companies
- involvement of accountants in cases of under payment of tax should be classed as gross negligence

(Kapadia G.P., 1972, Chapter 4)

These arguments were taken into account by the Ministry of Commerce, who drafted the Chartered Accountants Bill to include a provision giving the Ministry of Finance responsibility for dealing with all disciplinary cases of the ICAI which related to income tax matters. However, this provision was not acceptable to the accounting profession, as represented by the IAB. Many meetings were held to try and resolve this issue, after the Chartered Accountants Bill was introduced into Parliament and before the select committee completed its review of the Bill. The Ministry of Finance wanted the power to investigate all disciplinary cases that related to income tax matters and IAB wanted the ICAI to have total autonomy and independence over all matters relating to the accounting profession, including control over all disciplinary matters. *(Kapadia G.P., 1972, Chapter 4).*

Meetings were held between Mr Kapadia, a senior member of the IAB, and the CBDT and the Ministry of Commerce to try and resolve the problem but were not successful. Finally, Mr Kapadia met with the Ministry of Finance directly and a compromise was reached. The disciplinary committee of the ICAI would investigate all disciplinary matters and report back to the Council of the Institute, on which the CBDT would have a seat. The CBDT would therefore be able to review the ICAI's disciplinary process. In addition, all disciplinary matters relating to income tax would be subject to approval of the high courts. This provision still applies today, even though the ICAI had hoped that it would be removed within five years of the ICAI being set up. *(Kapadia G.P., 1972, Chapter 4)*

From the above it can be seen that the Ministry of Finance and the CBDT influenced one of the key roles of the ICAI included in the Chartered Accountants Act 1949 and hence influenced significantly the operation of the ICAI. The independence of the ICAI was significantly reduced in two ways. Firstly, by introducing government involvement directly in the operation of the institute in disciplinary matters and secondly, by introducing high court approval for certain decisions of the ICAI. This contributed to the ICAI being set up as a statutory institution and not a completely autonomous body, similar to the ICAEW in the UK.

Interactions between the international system and the ICAI

International considerations too played an important part in the setting up of the ICAI. The international system was important in two main ways. Firstly, the British accounting system had a strong influence on the Indian accounting system by introducing the ideal of the British accounting system into India before independence. This was done by the setting up of the IAB in 1930, with the intention that the IAB would evolve into an independent accounting institute like the ICAEW in the UK. Although this had not happened by the time of independence, the IAB was instrumental in trying to set up the ICAI in a similar fashion to the British example and ideal inherited at independence. The ICAI was modelled on the ICAEW but was modified in line with the cultural, social

and political context of India. In fact the ICAI that was set up, was set up as a statutory accounting institute. The ICAI was set up using statutory legislation promulgated through the parliamentary system. There was strong Government involvement in the setting up of the ICAI, the government was given powers to control the ICAI in the Chartered Accountants Act and Government was given significant representation on the Council of the ICAI. *(Kapadia G.P., 1972, Chapter 4)*

Secondly, the expert committee of the IAB reviewed the professional accounting associations in the UK, USA and Canada before preparing their report on the setting up of the ICAI. The recommendations in the report of the IAB were based on the set up of the foreign accounting professions studied and hence the foreign accounting bodies did influence, to some extent, the setting up of the ICAI. *(Kapadia G.P., 1972, Chapter 4)*

The Reaction Phase

The initial reaction phase of the setting up of the ICAI was seen from 1949 to 1960. In this phase, the ICAI set up its operational structure and established itself as an important regulatory body within the accounting system. During this period, the Government was again involved in influencing the ICAI and amending the Chartered Accountants Act 1949.

Intra-system activity (activity between the regulatory institutions within the accounting system) is seen in the reaction phase between the Government and profession accounting regulation and the ICAI and professional accounting regulation. Trans-system activity (activity between social systems neighboring the accounting system and the accounting system itself) is also seen between the parliamentary system and professional accounting regulation and the international system and professional accounting regulation. Both intra-system activity and trans-system activity are discussed below.

Intra-system Activity

Interactions between the Government (the Ministry of Commerce) and the Institute of Chartered Accountants of India

The Ministry of Commerce was an important influence on the ICAI in the reaction phase of the change. The Ministry of Commerce was represented on the Council of the ICAI and attended many of its functions. In their speeches at this time, the Government stated that it was their intention to allow the ICAI to operate with as much autonomy and independence as possible. However, since accounting had economic and social consequences, they would have to become involved in accounting regulation sometimes, but would try and keep this to a minimum. *(Kapadia G.P., 1972, Chapters 4, 5 and 6; interviews with senior representatives of the accounting profession on 3rd November 1998, 4th November 1998 and 18th November 1998; interviews with senior government officials on 10th and 17th November 1998)*

This led to a statutory accounting institute and profession. The ICAI were allowed to develop with little interference from the Government authorities. However, whenever there was an issue that affected the Government's interest or the public interest, the Government did become involved in accounting issues. In the reaction phase there were two issues where this happened. The first related to reciprocity and is discussed below. The second related to the setting up of the ICWAI and is discussed in Chapter 12.

In relation to the reciprocity issue, the ICAI requested the Government to negotiate with the British authorities (the Board of Trade in the UK) to try and gain recognition for members of the IACI to practice in the UK, since the members of the UK accounting bodies had the right to practice in India.

The Ministry of Commerce initiated discussions with the British Authorities on this issue. However, they were not successful and the ICAI was not given recognition. The ICAI were unhappy with this and wished to withdraw their recognition of professional accounting bodies who did not recognise the ICAI or its qualifications. The Government was concerned about this as they perceived

that their interests and negotiation position on other issues might be affected, if goodwill with the UK authorities was lost over the issue of reciprocity. They therefore put pressure on the ICAI to continue to recognise British professional accounting bodies and their qualifications. The ICAI did succumb to this pressure but not totally. They issued regulations, which gave recognition to foreign qualifications but included a clause, which stated that recognition would usually only be given if the ICAI were recognised. *(Kapadia G.P., 1972, chapter 6; Editorial, Chartered Accountant, vol viii, May 1960, pages, 429 to 431)*

This concerned the Ministry of Commerce and hence they initiated an amendment to the Chartered Accountants Act 1949 which allowed the Government to specify which foreign accounting qualifications would be accepted in India. A change to the Chartered Accountants Act 1949 was made using an amendment bill to the Chartered Accountants Act which was promulgated through the parliamentary system. *(Kapadia G.P., 1972, Chapter 6)*

The Ministry of Commerce was therefore influential in the reaction phase of the change. They were represented on the Council of the ICAI but did not control the day to day operations of the ICAI. However, the Ministry of Commerce did become involved in issues which they perceived to have public interest or affected their own interests. In the reaction phase, they influenced the ICAI on the issue of reciprocity. At the request of the ICAI, they tried to negotiate with the British authorities to gain recognition for the ICAI. When this was not successful, they influenced the ICAI, forcing the ICAI to issue regulations on reciprocity, which were more flexible that the ICAI would have wished. Finally, the Ministry of Commerce were directly responsible for changing the Chartered Accountants Act 1949, giving the Government the power to specify which foreign accounting qualifications would be recognised in India, rather than leaving this power with the ICAI.

The Institute of Chartered Accountants of India

In the reaction phase, the ICAI was allowed to set up its own secretarial and committee structure with little interference from Government and hence the fear of strong Government involvement in the day to day affairs of the ICAI was unfounded. The ICAI was able to operate as an autonomous body in most cases. *(Kapadia G.P., 1972, Chapter 6; interviews with senior representatives of the accounting profession on 3rd November 1998, 4th November 1998 and 18th November 1998)*

However, wherever the Government perceived that there were issues of wider public interest or where they felt that the Government's interests might be affected, they did become involved in the activities of the ICAI. The main issue in the reaction phase was the issue of reciprocity. In this issue the Government via the Ministry of Commerce, was able to impose their wishes on the ICAI.

As outlined above, the ICAI were keen to be recognised by the ICAEW and other UK professional accounting bodies. In addition, the Government was keen that the ICAI should continue to recognise the ICAEW and other foreign professional accounting bodies. Indeed, in the diffusion phase, the Government had put pressure on the ICAI to continue to recognise the UK professional accounting bodies and allow accountants with British qualifications to continue to practice in India. *(Kapadia G.P., 1972, Chapter 6)*

The ICAI asked the Ministry of Commerce to help in negotiations with the UK authorities about recognition of the ICAI. When this was not successful, the ICAI wanted to stop recognising accountants with British accounting qualifications. This was not considered desirable by the Indian Government and they directed the ICAI to continue to recognise British qualifications with no conditions of mutual recognition.

This was not acceptable to the ICAI. However, the ICAI did not disregard the wishes of the Government totally. The ICAI issued regulations on reciprocity, which allowed the recognition of foreign qualifications, but with the following conditions:

- the accountant to be recognised as a member of the ICAI must be resident in India.
- recognition would be for 5 years.
- the accountant would not allowed to vote or become a member of the council of the ICAI.
- the membership of the ICAI would cease if the accountant ceased to be resident in India.
- recognition would usually be given only if there was recognition by the foreign accounting body of the ICAI.

(Kapadia G.P., 1972, Chapter 6)

This was a compromise between the ICAI's position and the Government's position. Many members of the ICAI, including council members, felt that they had given in to the government rather than showing a strong, independent stance. However, they also recognised that the Government did have powers to regulate the ICAI under the Chartered Accountants Act. Hence, the ICAI accepted that they had had little choice in bowing to the will of the Government, since their position might well have been weakened further, if the government had insisted on full recognition of UK qualifications with no reciprocal measures. *(Kapadia G.P., 1972, Chapter 6)*

Despite the actions of the ICAI, the Government was not happy with the reciprocity provisions and in 1955 amended the Chartered Accountants Act to give the Government the right to specify those foreign accounting qualifications which would be accepted in India. *(Kapadia G.P., 1972, Chapter 6)*

Thus in the reaction phase the ICAI was given some autonomy to carry out its activities. However, Government was shown to be active and more influential than the ICAI on issues which the Government considered important.

Trans-system Activity

The parliamentary system and the ICAI

The parliamentary system was again used to change the accounting system in the reaction phase of the change. The Government initiated changes to the Chartered Accountants Act 1949 which related to the issue of reciprocity.

The changes were included in an amendment bill to the Chartered Accountants Act which was promulgated using a shortened parliamentary process. The amendment bill was introduced in Parliament in 1955 and debated in both houses of parliament. The Bill was not a major bill and hence was not referred for review to any parliamentary committee. The amendment bill was promulgated quickly since there was little opposition to the amendments in the bill. What opposition there was came from the accounting profession and the ICAI but was not enough to delay or change the Bill.

The amendment bill was promulgated by Parliament in 1955 to change the Chartered Accountants Act 1949, giving more power to the Government to specify which foreign qualifications would be recognised in India. *(Kapadia G.P., 1972, Chapter 6)*

The international system and the ICAI

The international system also influenced the ICAI in the reaction phase of the change. The issue of reciprocity and recognition of foreign qualifications and the possible impact that this might have on the Government of India was the reason for the changes to the Chartered Accountants Act 1949. *(Kapadia G.P., 1972, Chapter 6)*

The Government did not want goodwill between the Indian Government and British authorities, such as the Board of Trade, to be lost due to the actions of the ICAI. They were concerned that if the ICAI refused to recognise British

accounting qualifications, this might affect the Government's negotiating position with the British authorities on other issues. This led to the amendment of the Chartered Accountants Act 1949 in 1955 to allow the Government, rather than the ICAI, to specify which foreign qualifications would be recognised in India. Thus, the international system, in this case, the UK authorities, indirectly influenced accounting change in India. *(Kapadia G.P., 1972, Chapter 6)*

Culture and Social Context

Culture and social context are important in influencing accounting change and this includes changes to professional accounting institutions and regulations.

In India, the cultural values indicate that both statutory regulation and professional regulation will be important. This is seen in the accounting system in India, which has both strong statutory regulation through the Companies Act 1956 as discussed in chapters 6 to 9, and a statutory accounting profession headed by the ICAI. Indeed, both the Companies Act and the ICAI were set up very soon after independence, indicating the importance of both in India, which is consistent with the culture of India.

The cultural and social context are seen to be important in all phases of the change. In the source phase of the change, the colonial history of India played an important part in the setting up of the ICAI. The ideal of an independent accounting profession and institute along the British model was introduced into India, as were many other British institutions. The first step towards achieving an independent accounting profession was the setting up of the IAB pre-independence and this was done by the British Government in 1930. Some progress towards an independent accounting profession was made before independence but this had not been achieved at the time of independence. After independence, the IAB quickly took the initiative in proposing the setting up of an independent accounting. Had it not been for senior members of the IAB arguing for an independent professional accounting institute along the lines of

the ICAEW in the UK, the ICAI may well not have been set up as quickly as it was.

Culture and social context of India were also important in the diffuison phase of the setting up of the ICAI. The ICAI was not set up in a way that was identical to the ICAEW or any other British professional accounting institute. Instead, it was set up in line with the culture of India, both in the processes used to set up the ICAI and in its structure.

The ICAI was set up using statutory legislation, promulgated through the parliamentary system. The legislation, the Chartered Accountants Act 1949, contained regulations for the operation of the ICAI. For example, the Act specified that the Institute would be headed by a Council, the structure of the Council, elections to the council, the examinations process and the disciplinary procedure. The legislation set up a semi-independent accounting institute and profession which gave professional authority to the accounting system. Thus both statutory control and professional control were seen to be important in India, very much in line with what is expected with the culture and social context of India.

In addition, the setting up of the accounting profession took place with the co-operation of both the Government and the accounting profession as represented by the IAB. The IAB persuaded the Government that an autonomous accounting profession was needed at independence. They were able to do this due to the perception by the Government that accounting was seen to be an important tool for economic and social management. Accounting was therefore expected to facilitate economic growth and development, which was one of the most important priorities of the Government at independence.

Once agreement had been reached on the need for an autonomous accounting profession, the Government and the IAB worked closely together to set up the ICAI. Strong Government involvement was seen in the process of accounting change with the Ministry of Commerce:-

- preparing a scheme for the setting up of the accounting profession, circulating the scheme and obtaining feedback on the scheme.
- asking the IAB to set up an expert committee to review the scheme and feedback.
- approving the expert committee and setting its terms of reference.
- discussing key issues with the expert committee and influencing some of the proposals of the expert committee scheme, for example on the name of the institute and the issue of reciprocity.
- reviewing the proposals of the expert committee of the IAB.
- circulating the main proposals of the IAB scheme to set up an accounting profession, drafting the Chartered Accountants Act and steering it through the parliamentary process.
- meeting with the IAB and the Ministry of Finance to resolve problems raised by the Ministry of Finance.

Government involvement was also seen with the Ministry of Finance becoming actively involved in the process of accounting change, when there was the possibility of accounting and the ICAI affecting income tax.

The accounting profession too was influential in the setting up of the accounting profession and institute. They

- initiated the change and persuaded the Government that an independent accounting profession was both necessary and appropriate.
- they then set up the expert committee to review the Government's proposals and discussed key provisions with the Government. The Government's view was generally accepted but in certain areas, the expert committee did not totally accept the Governments suggestions, for example on the issues of reciprocity and on deciding on the name of the institute.
- the expert committee prepared a report on the setting up of the accounting profession, including a draft of the Chartered Accountants Bill, which they submitted to the Ministry of Commerce.
- they also then interacted with both the Ministry of Finance and Ministry of Commerce when objections were made by the Ministry of Finance to reach a compromise between what they proposed and what the Ministry of Finance objected to on the issue of the disciplinary process for cases that related to income tax.

Thus it can be seen that there was both involvement by the Government and the accounting profession as represented by the IAB in the setting up of the ICAI. This is consistent with the cultural and social context of India.

As well as strong Government involvement in the process of accounting change, strong government involvement is seen in the structure of the newly formed ICAI and accounting profession. The ICAI was headed by a council, which was regulated by the Chartered Accountants Act 1949. The Council was made up of both accountants who were to be elected and non- elected members who included government representatives from both the Ministry of Commerce and the Ministry of Finance and representatives from the chambers of commerce. Thus, the Council included government representatives who could monitor the development of the accounting profession and make suggestions where they considered this to be important and appropriate.

Culture and social context is also seen to be important in the reaction phase. In line with the culture of India, the ICAI was set up as a semi-independent professional body under an act of parliament. In the reaction phase, the ICAI was allowed to develop its own functional structure and to regulate the accounting profession with little interference from the Government. However, again as expected with the culture of India, the ICAI was not given total autonomy. The Government continued to influence the ICAI and the accounting profession in areas such as reciprocity which it considered to be important and of wider interest than just to the accounting profession.

To some extent, the Ministry of Commerce and the ICAI worked together to deal with the issue of reciprocity with the ICAI requesting the Government to negotiate with the British authorities on their behalf. However, when there was a difference of opinion between the Government and the ICAI on the issue of reciprocity, the Government were able to influence the actions of the ICAI. They were able to force the ICAI to soften their stance on the issue of reciprocity. Finally when the ICAI did not promulgate regulations which were acceptable to the Ministry of Commerce, the Ministry of Commerce exercised its powers and initiated an amendment to the Chartered Accountants Act. This increased

Government powers to ensure recognition of foreign qualifications. This again shows that both Government control and professional control are important in the accounting system in India. However, the Government retained greater control and influence over the accounting system than the ICAI.

From the above it can be seen that the culture and social context are important influences on accounting change. Culture and social context determine the institutions and processes that will be used to promulgate accounting change. In line with the cultural and social context of India, both statutory control and professional control of the accounting system is seen. Changes to the accounting system are promulgated through the parliamentary system and there is strong government control of accounting, both in the process used to promulgate the changes and direct government involvement in the institutions set up.

Politics and Accounting Change

From the above analysis, it can be seen that politics and political processes are important in changes that relate to the accounting profession in India. The setting up of the ICAI is surrounded by political activity, in the same way that legal accounting regulation is. Indeed, the setting up of the ICAI is political in the same ways that the promulgation of the Companies Act 1956 was.

Change to the accounting profession, in this case the setting up of the main professional accounting institution in India, the ICAI, was promulgated using the parliamentary system. Hence Parliament was actively involved in changes that related to the accounting profession. The ICAI was set up with a parliamentary charter, using statutory legislation promulgated through the parliamentary system.

In addition, as in all the accounting changes analysed, there is strong government involvement in accounting. In this case, both the Ministry of Commerce and the

Ministry of Finance were important in the process of change and the main issues were resolved outside the parliamentary system. This led to, perhaps, stronger involvement of Government, than in some of the other changes.

Finally accounting is political in the sense that the outcome of any accounting change including changes to the accounting profession, is seen to be the outcome of negotiations between all parties interested in accounting. In this case, most of the interactions took place between the senior accountants of the IAB representing the accounting profession and different Government departments, in particular the Ministry of Commerce and the Ministry of Finance. These interactions took place in direct meetings held between members of the IAB, the Ministry of Commerce and the Ministry of Finance. Some interactions also took place within the parliamentary process but the most important interactions took place outside the parliamentary system. The parties most influential and active in the lobbying and negotiation process are identified to be the Government itself (the Ministry of Finance and the Ministry of Commerce) and the accounting profession, represented by the IAB before the ICAI was set up and the ICAI, after it was set up in 1949.

Summary and Conclusion

The setting up of the ICAI can be analysed, using the theoretical framework proposed in chapter 3, into three phases, a source phase, a diffusion phase and a reaction phase.

In the source phase, change to the accounting system is initiated by the accounting profession itself, rather than by institutions outside the accounting system. However change to the accounting system would not have been possible through the efforts of the accounting profession, as represented by the IAB, alone. The setting up of the ICAI was only possible due to the involvement of important institutions outside the accounting system, in this case the Ministry of Commerce. The interests of the Ministry of Commerce and the IAB coincided

and therefore changes to the accounting system, to set up the ICAI took place. The reasons for the involvement of the Government were related to economic growth and development and these were concerns which came from outside the accounting system.

The diffusion and reaction phase of the change were composed of intra-system activity and trans-system activity. Intra-system activity occurred between the Ministry of Commerce and the accounting profession, as represented by the IAB before 1949 and the ICAI after 1949 and professional accounting regulation in both the diffusion and reaction phases of the change. Trans-system activity occurred between the parliamentary system, the Ministry of Finance and the tax authorities and the international system and professional accounting regulation, again in both the diffusion and reaction phases of the change.

Culture and social context is seen to be important in all three phases of the change and the whole process of change is surrounded by political processes. The change is initiated partly for economic reasons and the institutions and processes used to promulgate change are also influenced by culture. Accounting is political as accounting change is influenced by Parliament and Government and is the result of interactions between the different parties interested in accounting. These parties are identified as the Ministry of Commerce, the Ministry of Finance, Parliament, the accounting profession represented by the IAB before 1949 and the ICAI after 1949, and the international system. All of these try and influence accounting change in both the diffusion and reaction phase and the most successful are the Government and the accounting profession.

The above analysis also shows the importance of understanding the historical context of a country when investigating the development of its accounting system and not just looking at accounting isolation. Both cultural and political processes are important in influencing accounting change and the theoretical framework proposed is shown to be useful in analysing the setting up of the ICAI.

The initial reaction phase took place from 1949 to 1960. Within this period, two major changes took place which amended the working of the ICAI. One change related to reciprocity and is discussed above. The second related to the setting up of the ICWAI and is discussed in the chapter 12.

The ICAI continued to change and develop after 1960 and minor amendments to the ICAI and the Chartered Accountants Act 1949 were made periodically. However, there was only one major change to the working of the ICAI after 1960. This related to the promulgation of accounting standards by the ICAI and is discussed in chapter 11.

Chapter 11

Standard setting by the Institute of Chartered Accountants of India

Introduction

After being set up in 1949, under the Chartered Accountants Act 1949, the ICAI put in place its organisational structure and dealt with issues such as examinations, disciplinary procedures and reciprocity. The ICAI was closely linked to auditing and regulated chartered accountants who were the only accountants allowed to undertake audits in India. The ICAI also set up a research committee to look into accounting and auditing problems faced by chartered accountants in practice and issued recommendations and guidelines on accounting and auditing practices. These recommendations and guidelines were issued until 1977, when the ICAI set up a system to promulgate accounting standards. This was one of the most important developments in the history of the ICAI and is analysed below.

Standard setting by the Institute of Chartered Accountants

From independence in 1947 to 1977, the most important accounting regulations in India were included in the Companies Act, which was promulgated through the parliamentary system.. The ICAI too issued accounting regulations in the form of guidance notes and recommendations but these pronouncements were not mandatory and had no legal status. The recommendations of the ICAI, therefore, were only followed by the corporate sector on a voluntary basis and, thus, did not restrict the choices that companies had in choosing their accounting polices and practices. This led to the following criticisms of accounting in India in the 1960's and the 1970's:

- there was a lack of uniformity in accounting practices, which made the comparison of the financial reports of different companies difficult

- the variety of accounting practices available to companies made it possible for some managements to manipulate earnings

(Bhoopatkar P.R., Chartered Accountant, vol xxvi, November 1977, pages 251 to 258; interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998; Mohana Rao P., 1994, pages 278 to 293; Chakravorty D.K., 1994, pages 38 to 43, Chapter 4; Porwal L.S., 1993, pages 121 to 140)

In response to the above criticisms, the Council of the ICAI constituted a committee, under the executive committee of the Council, to promulgate accounting standards in April 1977. This committee was called the Accounting Standards Board of India (ASB) and its main functions were to:

- formulate Indian accounting standards to narrow the areas of differences and variety in accounting practices.
- persuade the corporate sector to adopt the accounting standards in the preparation and presentation of financial statements.
- review existing standards and issue guidance notes.

(Mohana Rao P., 1994, pages 278 to 293; Chakravorty D.K., 1994, pages 38 to 43, Chapter 4; Porwal L.S., 1993, pages 121 to 140; ICAI,1995)

The ASB implemented a due process system for promulgating Indian accounting standards. This due process system was similar to the systems used by the accounting profession in the UK and the International Accounting Standards Committee (IASC) to promulgate their standards.

After setting up the ASB and the standard setting process in 1977, the ICAI promulgated its first accounting standard (AS), on accounting policy disclosure, in November 1979. This standard was recommendatory until 1991. In total, the ICAI promulgated fifteen accounting standards from 1977 to 1998. All standards were promulgated as recommendatory to start with and most were made mandatory after some time. In the period 1977 to 1998, the ICAI made some changes to its standard setting process to make it more effective. However, despite these attempts at improving the standard setting process, there were still

many criticisms of the process in the 1990's. In response to these criticisms, the Government became directly involved in standard setting in the 1990's, with both the CBDT and the DCA initiating their own standard setting processes.

The setting up of the ICAI's accounting standard setting process and its operation from 1977 to 1998 is analysed below.

Analysis of the standard setting process by the Institute of Chartered Accountants of India

The setting up of the ASB and the standard setting process can be analysed, using the theoretical framework proposed in chapter 3 into source, diffusion and reaction phase as follows:

The Source Phase

The ASB was set up in 1977 by the ICAI to promulgate accounting standards using a due process based system. The ASB was constituted to improve the regulation of financial reporting by the IACI, in response to the following criticisms:

- there were criticisms relating to the lack of strong guidance and regulation over financial reporting practices by the ICAI.
- there were too many options available to companies and too much flexibility in the choice of accounting practices for companies. This made comparisons between companies very difficult.
- there were criticisms of the ICAI and its members, who were predominantly auditors or accountants in industry, for their lack of independence from the corporate sector.
- there were requests from the members of the ICAI itself, that there should be more guidance on financial reporting and auditing

(Bhoopatkar P.R., Chartered Accountant, Vol xxvi, November 1977, pages 251 to 258; Mohana Rao P., 1994, pages 278 to 293; Chakravorty D.K., 1994, pages 38 to 43, Chapter 4; Porwal L.S., 1993, pages 121 to 140)

These criticisms were made, amongst others, by the Government, users of accounts and academics.

In addition, in the early years, the focus of the ICAI had been on the training of chartered accountants, dealing with the issue of reciprocity and dealing with disciplinary procedures. By the 1970's, the ICAI was an established institution with a healthy membership and they felt that it was time to increase their status, profile and influence. Standard setting was seen to be an important way of doing this.

Furthermore, the ICAI was influenced by international developments in accounting standard setting. In the early 1970's, both the UK accounting profession and the IASC started their standard setting processes. These influenced the accounting system in India. The ICAI had been modelled on the ICAEW when it had been set up in 1949, although it had finally been set up in a way that was more consistent with Indian culture and processes. After 1949, the ICAI monitored international developments, particularly developments in the accounting profession in the UK due to the historical links and ties between India and the UK. Thus standard setting by the UK influenced the ICAI's standard setting process. *(Bhoopatkar P.R., Chartered Accountant, Vol xxvi, November 1977, pages 251 to 258; Gupta K., Chartered Accountant, Vol xxvii, July 1978, pages 4 to 8; Editorial, Chartered Accountant, Vol xxv, October 1976, pages 273 to 274)*

The ICAI also became an associate member of the IASC in 1974 and thus had an obligation to implement international accounting standards. The ICAI was given until 1977 to do this and chose to implement international accounting standards by setting up their own standard setting process. *(Bhoopatkar P.R., Chartered Accountant, Vol xxvi, November 1977, pages 251 to 258; Gupta K., Chartered Accountant, Vol xxvii, July 1978, pages 4 to 8; Editorial, Chartered Accountant, Vol xxv, October 1976, pages 273 to 274)*

The standard setting process chosen by the ICAI was similar to the standard setting processes used by both the UK accounting profession and the IASC. Thus, both the UK accounting profession and the IASC influenced the ICAI, who chose to promulgate accounting standards using a due process system similar to

that used by the UK accounting profession and the IASC. *(Bhoopatkar P.R., Chartered Accountant, Vol xxvi, November 1977, pages 251 to 258; Gupta K., Chartered Accountant, Vol xxvii, July 1978, pages 4 to 8; Editorial, Chartered Accountant, Vol xxv, October 1976, pages 273 to 274)*

From the above, it can be seen that it was the ICAI who set up the ASB and its standard setting process and hence the source of the change came from within the accounting system. The main reason for initiating the standard setting process was the ICAI's concern to improve their control over financial reporting in India. Thus the change was not activated from outside the accounting system but from within the accounting system. However, factors coming from outside the accounting system were also important considerations in the setting up of the ASB. These related to the international system and the setting up of standard setting in the UK and by the IASC. The ASB was also set up to counteract criticisms of the ICAI which were coming from parties and institutions outside the accounting system, for example the Government, users of accounts and academics.

The Diffusion Phase

Intra-system Activity

The ICAI and accounting standard setting

The setting up of the ASB and the Indian standard setting program was very much an initiative by the ICAI. As discussed above, the source of the change came from within the accounting system with the ICAI being instrumental in this change. However, other parties too were involved in the decision by the ICAI to set up a standard setting process. Before the ICAI set up the ASB and its standard setting process, the ICAI interacted informally with both the Government and the corporate sector, to gain their approval for the ICAI's plans. Had there been strong opposition from these parties to the standard setting proposals, it is unlikely that the ICAI would have proceeded with their plans.

(Mohana Rao P., 1994, pages 278 to 293; Chakravorty D.K., 1994, pages 38 to 43, Chapter 4; Porwal L.S., 1993, pages 121 to 140; Editorial, Chartered Accountant, Vol xxv, October 1976, pages 273 to 274)

The Council of the ICAI set up the ASB as a committee under its executive committee. The ASB was composed of chartered accountants, both members of the ICAI and Government accountants. Senior chartered accountants, usually from the larger auditing firms in India, were represented on the ASB together with accountants from the offices of the Comptroller and Auditor General of India (C&AG), the Central Board of Direct Taxes (CBDT) and the Department of Company Affairs (DCA). No other users or preparers of accounts were represented on the ASB. *(Mohana Rao P., 1994, pages 278 to 293; Chakravorty D.K., 1994, pages 38 to 43, Chapter 4; Porwal L.S., 1993, pages 121 to 140)*

The ASB implemented a system of due process to promulgate accounting standards. This system was very similar to that of the due process systems of the UK accounting profession and the IASC and included the following:

- the ASB would determine the broad areas in which accounting standards needed to be formulated.
- the ASB would set up study groups to consider the accounting issues in the areas chosen for accounting standards. The study groups would comprise of chartered accountants but would be set up such that there would also be participation in the groups by more than just the members of the ICAI. The study groups would interact with parties interested in accounting, such as the Government, the corporate sector, public sector undertakings, investor representatives, financial institutions and other organisations interested in accounting. The groups which are consulted are given in appendix 20.
- on the basis of the work of the study groups, the ASB would prepare an exposure draft (ED) of the proposed standard and issue this for comment from the members of the ICAI and all parties interested in accounting. While formulating exposure drafts, the ASB would take into consideration any other relevant regulations and practices in the corporate sector. The ASB would also, again, ascertain the views of parties interested in accounting, such as Government and the corporate sector. These are given in appendix 20.
- The exposure draft issued would generally include:

- a statement of concepts and fundamental accounting principles relating to the area of the accounting standard.
- definitions of the accounting terms used in the standard.
- recommendations on measurement, presentation and disclosure of financial information, as appropriate.

- after taking into consideration comments received on the exposure draft, the exposure draft of the proposed standard would be amended, if appropriate, and then finalised by the ASB and submitted to the Council of the ICAI for approval.
- the Council of the ICAI would consider the final draft of the proposed standard and make amendments if appropriate, in consultation with the ASB.
- the accounting standard would then be promulgated, under the authority of the Council of the ICAI.

(Mohana Rao P., 1994, pages 278 to 293; Chakravorty D.K., 1994, pages 38 to 43, Chapter 4; Porwal L.S., 1993, pages 121 to 140; ICAI, 1985; interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998)

The Indian due process system is similar but not identical to the due process system used in the UK. One major difference between the due process system in the UK and the due process system used in India is that the Indian system is less open than the system in the UK. In India, details of the representations received within the system for promulgating accounting standards are not made public. Thus, there is more secrecy in the Indian system, which is in line with the cultural characteristics of India.

In 1977, when the ICAI set up its standard setting process, they considered adopting international accounting standards promulgated by the IASC in total for use in India. However, the Council of the ICAI decided that this would not be in the national interests of India. Instead, the Council of the ICAI decided to promulgate their own standards but stated that international accounting standards would be used as the starting point for Indian accounting standards. The Indian accounting standards would then be adapted for the Indian context, as appropriate. In practice, though, the Indian accounting standards have not differed significantly from international accounting standards. *(Mohana Rao P.,*

1994, pages 278 to 293; Chakravorty D.K., 1994, pages 38 to 43, Chapter 4; Porwal L.S., 1993, pages 121 to 140; interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998; interview with senior Indian academic on 28th September 1998)

Once the ASB was constituted and the standard setting program set up, the ASB started work on its first accounting standard, which was on disclosure of accounting policies. This took over two years and was issued in November 1979 by the Council of the ICAI. The ASB and the ICAI issued fifteen standards in total from 1977 until the end of 1998. A list of the accounting standards issued by the ICAI is given in appendix 19.

Initially, the impact of Indian accounting standards was minimal. The standards that were promulgated were recommendatory in nature and did not conflict with the Companies Act 1956, which was the most important means of regulating accounting. The ICAI tried to encourage the use of Indian accounting standards by the corporate sector but was not able to force the corporate sector to comply with their accounting standards, as the standards had no legal status. *(interview with senior Indian academic on 28th September 1998; interviews with senior Government officials on 10th November 1998 and 17th November 1998; interviews with senior accounting personnel in companies on 27th October 1998 29th October 1998, 2nd November 1998 and 5th November 1998)*

From the above, it can be seen that the setting up of the ASB and the standard setting process was very much an initiative made by the ICAI. The ICAI set up the standard setting system and members of the ICAI were

- members of the Council of the ICAI which approved and promulgated the accounting standards.
- were represented on the ASB which prepared the accounting standards
- were key members of the working groups set up to review accounting problems.

There was some formal involvement of other parties in the setting up of the ASB and the standard setting process but the ICAI was the most important institution involved in this accounting change.

Interactions between the Government and the standard setting process by the ICAI

The Government was involved in the setting up of the standard setting process, both directly and indirectly. The Government, as part of the Council of the ICAI, was directly involved in approving the setting up of the ASB and the standard setting program of the ICAI.

Informal interactions also took place between the Government and the ICAI on the issue of standard setting. It is likely that interactions between the ICAI and the DCA would have taken place on the ICAI's proposal to set up the ASB and the standard setting process, in the early stages of the proposal. The ICAI would have informed the DCA of their intentions to set up a standard setting process and would have tried to gain the approval and support of the DCA for their proposals on standard setting. If the Government had strongly objected to the ICAI's proposes, the ICAI may well have either amended or abandoned their proposals. Such informal interactions between institutions and Government are common in India and perhaps more important than the formal involvement of the Government on the Council of the ICAI. *(interviews with senior Government officials on 10th November 1998 and 17th November 1998; Editorial, Chartered Accountant, Vol xxv, October 1976, pages 273 to 274)*

After the ASB was set up, it implemented a due process system to promulgate accounting standards, as outlined above. The Government, in common with all other parties who were interested in accounting, was consulted in the due process system used to promulgate accounting standards. Interactions with the Government took place throughout the due process system and, indeed, it is likely that the Government was consulted early on about the content of accounting standards.

In India, accounting standards do not prescribe accounting practices, which are different to the Companies Act. Instead, accounting standards either cover areas which are not covered by the Companies Act, (for example AS 11, accounting for the effects of changes in foreign exchange contracts) or require extra disclosures in areas which are covered by the Companies Act, (for example AS 2 on inventory valuation). In fact, in the latter case, there is usually a significant overlap between the Companies Act requirements and what is prescribed by the accounting standard. In addition, accounting standards, until very recently, have had no legal standing and are promulgated initially as recommendatory standards. Hence the accounting standards have not been a threat to Government regulation of accounting. Indeed, the Government left standard setting to the ICAI and did not become directly involved in standard setting until the 1990's. (*Survey of Financial reports of Indian Companies for the year ended 1996; Survey of financial reports of Indian Companies from 1950 to 1997; Mohana Rao P., 1994, pages 278 to 293; Chakravorty D.K., 1994, pages 38 to 43, Chapter 4; Porwal L.S., 1993, pages 121 to 140; Agarwal R.K., 1997)*

From the above, it can be seen that the Government was less involved in the setting up of the ASB by the ICAI than in most changes to the accounting system. They had little direct involvement in the setting up of the ASB and the standard setting program except as part of the Council of the ICAI which formally approved of the setting up of the ASB and the standard setting process.

However, it is likely that the Government did exert more influence over the setting up of the ASB and the standard setting process through informal interactions between the ICAI and the DCA. The DCA would have been consulted by the ICAI on their proposals, which might not have been implemented, had there not been Government approval and support for the proposals. In addition, the system chosen to promulgate accounting standards was one of due process, and the Government was significantly involved in this due process, at all stages of the process.

Trans-system Activity

Interactions between the corporate sector and the standard setting process by the ICAI

The corporate sector, like the Government, did not have much direct involvement in the setting up of the ASB and its standard setting process. The corporate sector was represented on the Council of the ICAI, through trade associations and chambers of commerce, and hence would have been involved in approving the setting up of the ASB and the standard setting process. But the corporate sector would not otherwise have formally been involved in the setting up of the standard setting process. However, it is likely that discussions would have been held with key members of the corporate sector, before the proposals for the standard setting process were finalised by the ICAI. This would have been done to ensure that the corporate sector did not object to the ICAI's proposals since the ICAI needed the support of the corporate sector for the proposals to be successful. *(interviews with senior Government officials on 10th November 1998 and 17th November 1998; interviews with senior accounting personnel in companies on 27th October 1998 29th October 1998, 2nd November 1998 and 5th November 1998; Sundararajan N.C., Chartered Accountant, Vol xli, February 1993, pages 653 to 655)*

The standard setting process that was set up by the ASB was one of due process in which the corporate sector was involved, as were all the other parties interested in accounting. The corporate sector was involved in the system used to promulgate accounting standards, in several ways. Firstly, the auditors of companies were members of the ICAI, running the Council and represented on the committees of the ICAI. Thus, the corporate sector would have been able to make its views known through their auditors. The ASB and the study groups that were set up to review accounting issues, would also have contained senior auditors and hence the corporate sector would, again, have been able to make their views known through their auditors. *(Mohana Rao P., 1994, pages 278 to 293; Chakravorty D.K., 1994, pages 38 to 43, Chapter 4; Porwal L.S., 1993, pages 121 to 140; interviews with senior accounting personnel in companies on 27th October 1998 29th October 1998, 2nd November 1998 and 5th November 1998; interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998; interview with senior Indian academic on 28th September 1998)*

As well as influencing key personnel on the committees, the corporate sector would have been consulted directly by the study group on the accounting issues being tackled. The corporate sector would also have been actively involved in sending in representations to the ASB on the exposure draft of the accounting standard, once it was issued. The ICAI would also have held meetings with the corporate sector to ascertain their views and to promote the acceptance of the accounting standards. The corporate sector, therefore, had plenty of opportunity to influence the provisions of the accounting standards that were promulgated, within the due process system for promulgating the accounting standards. Indeed the corporate sector would have been able to introduce modifications to exposure drafts if they felt strongly that the exposure drafts were inappropriate. *(Mohana Rao P., 1994, pages 278 to 293; Chakravorty D.K., 1994, pages 38 to 43, Chapter 4; Porwal L.S., 1993, pages 121 to 140; interviews with senior accounting personnel in companies on 27th October 1998 29th October 1998, 2nd November 1998 and 5th November 1998; interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998; interview with senior Indian academic on 28th September 1998)*

As the due process system is not open, it is not easy to analyse the representation made by the corporate sector. However, the ICAI was keen to establish accounting standards as an important regulatory mechanism within the accounting system. Thus, they would not have wanted to promulgate accounting standards which the corporate sector was against and would not follow. The accounting standards were not legally binding and not mandatory, at least to start with and thus the ICAI would have needed the support of the corporate sector to promulgate successful accounting standards. To gain the support of the corporate sector, the ICAI:

- implemented a due process system which involved the corporate sector and other parties interested in accounting, in the accounting standard setting process. The ICAI hoped that the corporate sector would then be more likely to follow the accounting standards that were promulgated.
- amended any provisions in accounting standards not acceptable to the corporate sector.
- introduced flexibility and choices into the accounting standards
- made the accounting standards recommendatory

- did not promulgate accounting standards which conflicted with other regulations that the corporate sector had to follow.

  (Mohana Rao P., 1994, pages 278 to 293; Chakravorty D.K., 1994, pages 38 to 43, Chapter 4; Porwal L.S., 1993, pages 121 to 140; interviews with senior accounting personnel in companies on 27th October 1998 29th October 1998, 2nd November 1998 and 5th November 1998; interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998; interview with senior Indian academic on 28th September 1998)

Due to the above, the corporate sector did not feel that their interests would be affected by the standard setting process and hence did not oppose the proposals made by the ICAI to promulgate accounting standards. These issues are seen in all countries and institutions where accounting professions are involved in accounting regulation for which there is no legal support.

Once the standard setting process was implemented, the ASB and the Council of the ICAI took over two years to promulgate the first accounting standard on accounting policy disclosure. Accounting policy disclosure was, in fact, a relatively contentious standard since the corporate sector was against increasing disclosures of any kind. However, other parties such as the Government, considered improving accounting disclosures to increase the transparency of accounts to be important. This difference of opinion may, in part, explain why there was such a long delay in the promulgation of the first accounting standard, which was promulgated as a recommendatory standard in 1979.

From the above, it can be seen that, although the corporate sector had little direct involvement in the setting up of the ASB and the standard setting program of the ICAI, they were involved in the system of standard setting, once it was initiated. Indeed, the corporate sector was an important influence on the standard setting process and the accounting standards that were promulgated.

The international system and the standard setting process by the ICAI

The international system was an important influence in the setting up of the ASB and the standard setting program by the ICAI. The whole standard setting

system in India is similar to the standard setting process used by the UK accounting profession. In addition, whenever accounting standards are promulgated in India, accounting developments in the UK and USA are studied and, in most cases, their content incorporated into Indian accounting standards. *(Gupta K., Chartered Accountant, Vol xxvii, July 1978, pages 4 to 8; Sarda N.P., Chartered Accountant, Vol xliv, June 1996, pages 13 to 18; Pasricha J.S., Chartered Accountant, Vol xxxviii, September 1989, pages 203 to 206; Agarwal R., and Raghunathan V., Chartered Accountant, Vol xlvii, January 1999, pages 34 to 45)*

International accounting standards too have been influential in India. The ICAI became an associate member of the IASC in 1974 and was given until 1977 to fulfil its obligations to implement international accounting standards in India. This led to the setting up of a standard setting process in India in 1977. *(Bhoopatkar P.R., Chartered Accountant, Vol xxvi, November 1977, pages 251 to 258; Gupta K., Chartered Accountant, Vol xxvii, July 1978, pages 4 to 8; Editorial, Chartered Accountant, Vol xxv, October 1976, pages 273 to 274)*

When the standard setting process was set up in 1977, the Council of the ICAI considered whether India should promulgate its own accounting standards or just adopt international accounting standards. The Council decided in favour of promulgating Indian accounting standards. However, they confirmed that international accounting standards would be taken into account by the ASB. On accounting issues for which there existed an international accounting standard, the international accounting standard would be the starting point for the Indian accounting standard. The accounting standard would then be adapted for the Indian social, economic and political context. *(interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998; Mohana Rao P., 1994, pages 278 to 293; Chakravorty D.K., 1994, pages 38 to 43, Chapter 4; Porwal L.S., 1993, pages 121 to 140)*

From the above, it can be seen that the international system had an important influence over accounting change in India. Changes to the accounting system to introduce standard setting, were based on developments in accounting standard setting in the UK and by the IASC. The due process system implemented in India was, also, very much based on the due process systems used by the UK

accounting profession and the IASC. In addition, the UK accounting standards and international accounting standards influenced the content of Indian accounting standards.

The Reaction Phase

The first Indian accounting standard was promulgated in 1979, more than two years after the ASB and the standard setting process was introduced by the ICAI. There was little immediate reaction to the promulgation of the accounting standard since it was recommendatory in nature and, hence, was only followed by companies if they chose to do so. The ASB and the Council of the ICAI promulgated fifteen accounting standards between 1997 and the end of 1998, all of which were recommendatory to start with. These are given in appendix 19.

In the longer term, the ICAI has tried to improve the standard setting process and improve compliance with its accounting standards. There has been both support and criticism of the ICAI's standard setting program in the longer term, and this is discussed below.

Intra-system Activity

The ICAI and accounting standard setting

The reaction to the standard setting process of the ICAI has been one of ongoing change to the standard setting process. Initially there was little reaction to the first standards issued by the ICAI for the following reasons:

- accounting standards were recommendatory and hence did not have to be followed by the corporate sector.
- accounting standards which may have caused problems for the corporate sector were very flexible and did not prescribe one accounting policy which would have restricted company choice. For example AS 2 on inventory valuation and AS 5 on depreciation do not prescribe one accounting treatment.

- accounting standards did not prescribe policies and practices which contradicted the requirements of the Companies Act and, hence, did not add to the regulations that the corporate sector already had to follow.
- the corporate sector was actively involved in the due process system for promulgating the accounting standards and hence were able to influence the accounting standards that were promulgated, such that they were acceptable to the corporate sector.

  (Mohana Rao P., 1994, pages 278 to 293; Chakravorty D.K., 1994, pages 38 to 43, Chapter 4; Porwal L.S., 1993, pages 121 to 140; interview with senior Indian academic on 28th September 199; Agarwal R.K., 1997)

When first promulgated, all accounting standards were recommendatory in character. The ICAI then worked actively with the corporate sector and other parties to create awareness about the accounting standards and to encourage the corporate sector to follow the accounting standards. This was done through a variety of means, which included:

- involving the corporate sector in the standard setting process, such that they contributed to the standards that were promulgated. It was hoped by the ICAI, that this would encourage companies to follow the accounting standards.
- options were included in accounting standards on which agreement for one particular treatment could not be achieved for example AS 2, accounting for inventory.
- holding seminars, lectures and workshops with the corporate sector to persuade them of the appropriateness of following accounting standards.

  (interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998; Presidents page, Chartered Accountant, Vol xxxii, August 1983, pages 75 to 76; Agarwal K.M., Chartered Accountant, Vol xl, February 1992, pages 679 to 681; Dalal A.H., Chartered Accountant, Vol xxxix, January 1991, pages 576 to 578; Matthew J., Chartered Accountant, Vol xlvii, August 1998, pages 32 to 35)

Once awareness had been created about accounting standards, the ICAI tried to improve compliance with the accounting standards by making them mandatory. The first standards to be made mandatory were AS 4 and AS 5 on 1st January 1987. All other standards promulgated before 1991 were made mandatory on 1st April 1991 except for AS 2 on valuation of inventories, AS 3 on changes in financial position and AS 6 on depreciation accounting. These standards were

still recommendatory at the end of 1998. Accounting standards promulgated after 1991 were made mandatory on 1st April 1994 or 1st April 1995. Details of when accounting standards were made mandatory are given in appendix 19.

There was some confusion over what was meant by "mandatory" and this had to be clarified by the ICAI in its monthly journal. "Mandatory" was clarified to mean that companies were expected to follow accounting standards. If they did not, then the auditors of the company had to ensure that disclosures, stating that accounting standards were not being followed, were made. Auditors were not required to qualify audit reports unless such disclosures were not given. Auditors, who were all chartered accountants, thus were given an important role in the enforcement of accounting standards. They were expected to encourage companies to follow accounting standards and ensure that disclosures were made if companies did not follow accounting standards. However, provided that companies made adequate disclosures, they were not required to follow even mandatory accounting standards. Indeed, since the accounting standards were not legally binding, there was very little the ICAI could do to enforce accounting standards other than try and persuade the corporate sector to adhere to their standards. (*Chartered Accountant, Vol xxxix, January 1991, pages 579 to 582; Chartered Accountant, Vol xxxix, December 1990, pages 510-512)*

Three accounting standards had not been made mandatory by the end of 1998. AS 3 on changes in financial position (the equivalent of the statement and source and application and of funds) had never really been accepted. AS 3 was bypassed by the cashflow statement requirement issued by Securities and Exchange Board of India in 1996.

AS 2 and AS 6 covered inventory and depreciation, two areas where companies had many choices in their accounting practices. Agreement could not be reached on one particular treatment since the corporate sector was against any restrictions in these areas. Thus, these accounting standards contained choices and remained recommendatory. The ICAI recognised that these accounting standards would not be followed in practice and took the pragmatic decision to

leave the accounting standards as recommendatory rather than have them openly flouted by most companies. These standards were still recommendatory, at the end of 1998, although plans to revise the standards in 1999 and to make them mandatory were being considered by the ICAI in 1998. *(interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998; Agarwal R.K., 1997)*

During the reaction phase to the standard setting process, which is ongoing, there has been some support for the standard setting process of the ICAI. The standards promulgated have provided some specific guidelines for the preparation of financial reports and have attempted to remove some of the diversity in accounting practices. *(Presidents page, Chartered Accountant, Vol xxxii, August 1983, pages 75 to 76; Agarwal K.M., Chartered Accountant, Vol xl, February 1992, pages 679 to 681; Dalal A.H., Chartered Accountant, Vol xxxix, January 1991, pages 576 to 578; Matthew J., Chartered Accountant, Vol xlvii, August 1998, pages 32 to 35; interviews with senior accounting personnel in companies on 27th October 1998 29th October 1998, 2nd November 1998 and 5th November 1998; Mohana Rao P., 1994, pages 278 to 293; Chakravorty D.K., 1994, pages 38 to 43, Chapter 4; Porwal L.S., 1993, pages 121 to 140)*

However, there have also been many criticism of the ICAI's standard setting system and these have outweighed the support received for the standard setting process. These criticisms have included the following:

- accounting standards in India are too flexible and contain too many choices which does not reduce the variability seen in financial reporting practices.
- the ASB does not represent the wider interest group and contains only chartered accountants. The ASB membership should be widened to include representatives of the wider interest group.
- the enforcement of accounting standards by the ICAI has been poor and the corporate sector has been reluctant to comply with accounting standards. Accounting standards have been recommendatory to start with and hence only followed by the corporate sector if deemed desirable in their own interests. Even when accounting standards have been made mandatory, compliance has only improved by a small amount, usually only in the larger companies in India. Since accounting standards are not legally binding, there is little that the ICAI can do to enforce compliance with their accounting standards.

There have been two main suggestions to improve compliance with accounting standards, both involving Government support for accounting standards. One suggestion has been made that accounting standards promulgated by the ICAI should be supported by the DCA and the Government. For example by the Government issuing regulations stating that audit reports will be qualified unless accounting standards, promulgated by the ICAI, are followed. Another suggestion has been that accounting standards should be incorporated into the Companies Act. The first suggestion is more acceptable to the ICAI than the second.

- accounting standards in India have been promulgated in an ad hoc manner and a conceptual framework needs to be developed to identify objectives of accounting and to improve the quality of the accounting standards promulgated.

- the ICAI has made slow progress with only fifteen accounting standards issued since 1977.

- there have been some arguments that the ASB should reorganise on the format of Financial Accounting Standards Board in the USA or the Accounting Standards Board of UK, and become more independent of the accounting profession.

- there have been some arguments that Indian accounting standards have been too similar to accounting standards promulgated by the UK accounting profession and the IASC which is not appropriate. Indian accounting standards should not just follow the accounting standards of other countries and other institutions.

(Mohana Rao P., 1994, pages 278 to 293; Chakravorty D.K., 1994, pages 38 to 43, Chapter 4; Porwal L.S., 1993, pages 121 to 140; interviews with senior Government officials on 10th November 1998 and 17th November 1998; interviews with senior accounting personnel in companies on 27th October 1998 29th October 1998, 2nd November 1998 and 5th November 1998; interview with senior Indian academic on 28th September 1998; Mahindra A.K., Chartered Accountant, Vol xxxviii, April 1990, pages 767 to 777; Dalal A.H., Chartered Accountant, Vol xxxix, January 1991, pages 576 to 578; Sarda N.P., Chartered Accountant, Vol xliv, June 1996, pages 13 to 18; Matthew J., Chartered Accountant, Vol xlvii, August 1998, pages 32 to 35; Rangachary N., Chartered Accountant, Vol xlvii, November 1998, pages 51 to 57;

Agarwal R., and Raghunathan V., Chartered Accountant, Vol xlvii, January 1999, pages 34 to 45)

The ICAI has tried to address some of these criticisms over time. For example, they have widened the consultation within the due process system, have speeded up making accounting standards mandatory and have worked actively to persuade the corporate sector to follow accounting standards. In practice, what

has been seen is that the larger companies do, generally, follow mandatory accounting standards. The compliance problem lies mainly with the rest of the corporate sector, with all but the largest companies in India. Thus, the criticisms of the standard setting process have not abated and the enforcement of accounting standards is still the main problem with the standard setting process in India. *(Editorial, Chartered Accountant, Vol xxxii, November 1983, pages 287 to 288)*

The criticisms of the standard setting program may have led to a negative reaction against the ICAI and its standard setting program in the 1990's. These criticisms may have partly contributed to recent developments in standard setting in India. In 1995 and 1996, the CBDT initiated a system to promulgate its own tax accounting standards. In 1997 and 1998, the Companies bill 1997 and the Companies (Amendment) Ordinance 1998 gave legal support for accounting standards and set up a National Advisory Council on Accounting Standards which would take over standard setting from the ICAI. These developments are discussed in chapter 9.

Since 1998, the ICAI have revised AS2 (Accounting for inventories) and made this standard mandatory. The ICAI have issued exposure drafts on borrowing costs and segmental reporting, which are still being considered. In 1999, the ICAI celebrated 50 years of existence, after being set up under the Chartered Accountants Act in 1949. These celebrations involved a series of meetings to which the Prime Minister and other ministers were invited. At these meetings, the Prime Minister suggested more involvement of the ICAI and chartered accountants in government finances, a role which the ICAI are keen to develop.

Interactions between the Government and standard setting by the ICAI

In the reaction phase, the Government through the DCA has been involved in the standard setting process, in several ways. The DCA and other Government departments are represented on the Council of the ICAI and hence are involved in the approval of accounting standards prepared by the ASB. The Government is also consulted about accounting standards, early on in the standard setting process, and hence the Government has the opportunity to influence the content

of accounting standards, usually before the exposure draft stage. *(Sundararajan N.C., Chartered Accountant, Vol xli, February 1993, pages 653 to 655; interviews with senior Government officials on 10th November 1998 and 17th November 1998)*

The Government in India has always recognised that accounting has social and economic consequences and that accounting can be used as a tool for social and economic development. Thus, the Government has always taken a keen interest in accounting in India since independence. For example, the ICAI was set up in 1949 with Government support. When the ICAI was set up, the Government stated that a professional accounting institute to lead the accounting profession was appropriate and that Government involvement in accounting matters should be minimal.

The Government was again supportive of the ICAI in 1977 when it initiated its standard setting program. In practice, the Government did not interfere unduly in the accounting standards that were promulgated, especially since these were not in conflict with the Companies Act 1956. Standard setting was left in the hands of the ICAI and Government involvement limited to giving their views on the accounting standards, within the due process system. This changed somewhat in the 1990's.

Until the 1990's, the Government did not take an active role in the standard setting process of the ICAI. Instead, they monitored the process, its benefits and its criticisms. In the 1990's the Government became more active in accounting, perhaps because of the criticisms outlined above, which they perceived were not being adequately addressed by the ICAI.

In 1997, the DCA decided that it was time that accounting standard setting was carried out by the Government and introduced the National Advisory Committee on Accounting Standards in the Companies Bill 1997 and the Companies (Amendment) Ordinance 1998. This is discussed in chapter 9. The National Advisory Committee on Accounting Standards had not been set up by the end of 1998, the time period for this thesis. However, it is expected that the National Advisory Committee on Accounting Standards will significantly alter standard

setting in India and may well end the standard setting program of the ICAI in the future, although, perhaps not immediately. *(Chapter 9)*

From the above, it can be seen that Government did not directly affect the standard setting program of the ICAI significantly until the 1990's. Until the 1990's, accounting standard setting was left very much in the hands of the ICAI. In the 1990's the DCA decided to take control of accounting standard setting and did this through the Companies (Amendment) Ordinance 1998 to set up a National Advisory Committee on Accounting Standards.

Trans-system Activity

Interactions between the tax authorities and standard setting by the ICAI

The tax authorities were not significantly involved in the reaction phase of the standard setting process of the ICAI until the 1990's. The tax authorities were represented on the Council of the ICAI as were the DCA and representatives of the corporate sector. The tax authorities would also have been involved in the standard setting process of the ICAI, as were all parties interested in accounting. They would have been consulted by the ICAI on the proposals for accounting standards and would have had the opportunity to send in representations to the ASB, on exposure drafts of accounting standards.

However, until the 1990's the tax authorities did not become more involved in the standard setting process of the ICAI. In the 1990's, the CBDT in the ministry of finance initiated its own standard setting process as they considered that the accounting standards promulgated by the ICAI might be affecting tax collection. The ICAI were very concerned about this development and argued against it strongly, thus managing to limit standard setting initiatives by the tax authorities. The promulgation of tax accounting standards by the CBDT and the reaction of the ICAI to this are discussed in chapter 13.

Interactions between the corporate sector and standard setting by the ICAI

The corporate sector continued to influence the accounting standard setting program of the IACI in the reaction phase. Like the Government, the corporate sector was represented on the Council of the ICAI, which approved the accounting standards that were promulgated. They were also involved and influential in the due process system used by the ASB and the ICAI to promulgate accounting standards. The ICAI worked closely with the corporate sector, ascertaining their views on the accounting standards during the standard setting process. If the corporate sector was unhappy with the accounting standards, inevitably the ICAI accommodated the views of the corporate sector, usually either by amending the provisions or introducing options and choices into the accounting standards. The corporate sector was therefore important in determining the final accounting standards that were promulgated. *(interviews with senior accounting personnel in companies on 27th October 1998 29th October 1998, 2nd November 1998 and 5th November 1998; interview with senior Indian academic on 28th September 1998)*

The ICAI used many different ways of persuading the corporate sector to follow accounting standards. For example, the ICAI organised lectures, seminars and workshops in which they presented their case for compliance with their accounting standards. However, since the standards were recommendatory and had no legal backing, the ICAI had problems in enforcing compliance with the standards. Thus, the corporate sector was seen to be influential in standard setting by the ICAI, since if they did not wish to follow accounting standards, the ICAI had to make compromises in their standards. *(Presidents page, Chartered Accountant, Vol xxxii, August 1983, pages 75 to 76; Agarwal K.M., Chartered Accountant, Vol xl, February 1992, pages 679 to 681; Dalal A.H., Chartered Accountant, Vol xxxix, January 1991, pages 576 to 578; Matthew J., Chartered Accountant, Vol xlvii, August 1998, pages 32 to 35; Editorial, Chartered Accountant, Vol xxxii, November 1983, pages 287 to 288; interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998)*

This was also seen in the process of making accounting standards mandatory. After accounting standards had been recommendatory for a while, the ICAI changed their status from being recommendatory to being mandatory. The first

standards to be made mandatory were AS 4 and AS 5 and these were made mandatory in 1987. Most of the other standards were made mandatory in 1991, 1994 and 1995. Three standards (AS 2, AS 3 and AS 6) were still not mandatory by the end of 1998 and these were the accounting standards, which the corporate sector had indicated that they would not follow. Thus the ICAI only changed the status of accounting standards which were either not contentious, or standards, which over time, the ICAI were able to persuade the corporate sector to voluntarily follow. *(interviews with senior accounting personnel in companies on 27th October 1998 29th October 1998, 2nd November 1998 and 5th November 1998; interview with senior Indian academic on 28th September 1998; Agarwal R.K., 1997; Mohana Rao P., 1994, pages 278 to 293; Chakravorty D.K., 1994, pages 38 to 43, chapter 4; Porwal L.S., 1993, pages 121 to 140)*

In the longer term, the corporate sector was supportive of the ICAI in its efforts to argue against the proposals by the DCA to set up a National Advisory Council on Accounting Standards and proposals by the CBDT to promulgate tax accounting standards. This may have been due to the corporate sector fearing that the Government would be more active in standard setting and enforce the standards more effectively, thus reducing the freedom which the corporate sector had in choosing accounting practices and polices. Indeed, the corporate sector probably preferred standard setting to remain in the hand of the ICAI, since companies had become familiar with the standard setting processes of the ICAI and were able to influence the accounting standards that were promulgated by the ICAI significantly.

Interactions between the international system and standard setting by the ICAI

In addition to influencing the source and diffusion phases of the change, the international system also influenced the reaction phase of the change.

The ICAI took into account international developments in accounting practice in their process for promulgating their standards. Reviews of accounting practice in other countries were undertaken and these focused mainly on accounting in the UK and the USA. The provisions of accounting standards in the UK and USA

were incorporated into Indian accounting standards, in most cases. *(Gupta K., Chartered Accountant, Vol xxvii, July 1978, pages 4 to 8; Sarda N.P., Chartered Accountant, Vol xliv, June 1996, pages 13 to 18; Pasricha J.S., Chartered Accountant, Vol xxxviii, September 1989, pages 203 to 206; Agarwal R., and Raghunathan V., Chartered Accountant, Vol xlvii, January 1999, pages 34 to 45)*

In addition, international accounting standards were also reviewed during the process of promulgating accounting standards in India. The ASB did not totally adopt international accounting standards for use in India. Instead, the ASB stated that they would use international accounting standards as a starting point for their accounting standards, but would then adapt them for the Indian social and economic context. They would gives due consideration to international accounting standards and try to integrate them into Indian accounting standards, to the maximum extent possible, in the light of conditions prevailing in India. In practice, though, there have been very few differences between international accounting standards and Indian accounting standards promulgated by the ICAI. *(Gupta K., Chartered Accountant, Vol xxvii, July 1978, pages 4 to 8; Sarda N.P., Chartered Accountant, Vol xliv, June 1996, pages 13 to 18; Pasricha J.S., Chartered Accountant, Vol xxxviii, September 1989, pages 203 to 206; Agarwal R., and Raghunathan V., Chartered Accountant, Vol xlvii, January 1999, pages 34 to 45)*

More recently, in the 1990's, the ICAI has become a board member of the IASC and, hence the adoption of international accounting standards has become more important. In fact, the ICAI are keen to promulgate accounting standards in all areas that the IASC has done and, as discussed in interviews, is aiming to achieve this as soon as possible. *(interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998)*

The ICAI also sees its future as a key international player in accounting standard setting. In particular the ICAI would like to develop as a leader in providing accounting services and expertise to other developing countries. For example, the ICAI has entered into agreements in 1998 with Nepal and the Ukraine, to provide accounting expertise to these countries and to help them develop their accounting systems. The ICAI would like to enter into similar contracts with

other developing countries. *(interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998)*

Culture and Social Context

The cultural values of India indicate that there will be both statutory control over the accounting system and strong control over the accounting system by an accounting profession. In addition, strong government control is expected in the accounting system of India.

This is clearly seen in the setting up of the ASB and the standard setting system by the ICAI. The ICAI is an important institution within the accounting system and was set up very soon after independence with co-operation between the Ministry of Commerce and senior accountants on the Indian Accounting Board. The priority of the ICAI after independence was to increase the number of accountants in India and implement an effective disciplinary process. Regulation of financial reporting was also part of the role of the ICAI and the ICAI fulfilled this through setting up various committees such as a research committee to advise on accounting issues and issuing recommendations and guidelines.

However, this was not seen as effective and, once the ICAI had established itself, the Council of the ICAI addressed the issue of regulating financial reporting. They did this by constituting the ASB and setting up a standard setting program in 1977. It was hoped that this would improve the ICAI's control and power over financial reporting. These changes made to the accounting system by the ICAI were consistent with the development of an active accounting profession, which was pro-active in accounting regulation.

The standard setting program initially had little impact in India. This was due to the problem of enforcing accounting standards as they were not legally binding. This too is consistent with the culture of India. Both statutory and professional control are expected to be important in India, but, as seen in the other changes to the accounting system, statutory control is the more important. This may explain

the lack of impact that the standard setting program in India had initially and why the ICAI had to implement a due process system to promulgate accounting standards.

Without a due process system which involved the corporate sector in the standard setting process, there would have been very little chance of the corporate sector following any accounting standards promulgated by the ICAI. In addition, the ICAI had to issue recommendatory standards initially to establish the standard setting process. As the standard setting process became more established and the ICAI persuaded the corporate sector to follow accounting standards, most of the standards were made mandatory which improved the role of accounting standards a little. However, even when made mandatory, the compliance by the corporate sector with accounting standards was poor as the accounting standards were not legally binding. Thus, over time a stronger accounting profession did develop but legal control was still seen to be the most important regulatory mechanism in India. This too is consistent with the culture of India.

In addition, government control of accounting still remained strong and more important than professional regulation of accounting, in line with the culture of India. This was seen in the reaction to standard setting by the ICAI in the 1990's. Both the CBDT and the DCA initiated their own accounting standard setting processes in response to the criticisms of the ICAI's standard setting process and due to the perception that accounting was as important tool for social and economic development.

The cultural characteristics of India also indicate that there will be a mixture of secrecy and transparency in the accounting system of India. Indeed, the cultural values are slightly contradictory and it is not clear which of these accounting values will be dominant. The combination of cultural values, including both the universal accounting values identified by Hofstede, and the country specific cultural values determines which of the accounting values will be the more important. In India, it appears that secrecy will be more prevalent than transparency, as indicated in the survey of financial reports and as discussed in the interviews. *(Survey of Financial reports of Indian Companies for the year ended 1999;*

Survey of financial reports of Indian Companies from 1950 to 1997; interviews with senior accounting personnel in companies on 27th October 1998 29th October 1998, 2nd November 1998 and 5th November 1998; interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998)

This is very much supported in the analysis of the standard setting program of the ICAI. The corporate sector in India would prefer to give less information rather than more information and, indeed only give material disclosures when they are legally required to do so. Thus, they would not have been in favour of accounting standards which increased the disclosures they had to make. This explains, in part, why the standard setting process was slow, why standards contained choices and flexibility, why there was such a delay in making standards mandatory and why compliance with the accounting standards was so poor. The element of secrecy is also seen in the lack of openness in the standard setting process of the ICAI.

Finally, the importance of understanding the historical context of a country is, again, shown. The standard setting program that was set up, was based on the standard setting process in the UK. Before independence, Britain introduced many systems into India such as the legal system and the parliamentary system. After independence, Britain continued to influence India. When India set up institutions and processes, they often referred to developments in the UK and tried, as far as possible, and as far as the cultural, social, economic and political context would allow, to set up systems similar to those found in the UK. This is seen in this change, with the standard setting process being very much based on the UK system.

Politics and Accounting Change

The analysis of the setting up of the standard setting process in India clearly shows the political nature of accounting in India. The process used to promulgate accounting standards in India is one of due process in which all parties interested in accounting take part. All parties interested in accounting are

consulted by the ASB at various stages in the due process system. They are also invited to send in representations on the exposure drafts issued by the ASB, before standards are finalised and promulgated by the Council of the ICAI.

The process is not open and hence details of the parties influencing the process, and the comments they make are not publicly available. However, the main parties interested in, and influential over the standard setting process, are identified in the literature and in interviews as the Government and the corporate sector. Both are represented on the Council of the ICAI, both are actively consulted by the ASB on accounting standards and both send in representations to the ASB and the ICAI. Thus the accounting standards that are promulgated are the direct result of the interactions between the accounting profession and the Government, the corporate sector and other parties interested in accounting. This leads to only accounting standards acceptable to the main parties interested in accounting, being promulgated.

In addition, once again, as in all the other changes, accounting is seen to be political in that there is strong government involvement in accounting matters. This is seen with the Government being represented on the Council of the ICAI and consulted about the accounting standard setting process and the accounting standards that are promulgated. However, until the 1990's, government involvement in accounting standard setting was, perhaps, less important than in the other accounting changes analysed. In the 1990's, Government was seen to become more involved in standard setting, with both the CBDT and the DCA proposing their own standard setting systems.

Summary and Conclusion

As discussed above, the setting up of the ASB and the standard setting process can be analysed into source, diffusion and reaction phases, using the theoretical framework outlined in chapter 5. In this change, unlike most of the other changes, the change was initiated by the ICAI and not by events arising from

outside the accounting system. The ICAI initiated the changes to the accounting system to improve its role in the regulation of financial reporting. This was done by setting up the ASB and implementing a due process system for promulgating accounting standards. The system chosen for promulgating accounting standards was influenced by international developments in accounting, in particular the UK's standard setting program and the IASC's standard setting program.

The diffusion and reaction phases of the changes are composed of intra-system activity and trans-system activity. The main intra-system activity, in the diffusion and reaction phases, occurred between the ICAI and the Government and accounting regulation. The main trans-system activity, in the diffusion and reaction phases, occurred between the corporate sector and the international system and accounting regulation. The Government and the corporate sector were seen to be important, particularly in the reaction phase, influencing the accounting standards that were promulgated from 1977 to 1998. In addition, the Government was seen to increase its importance in standard setting in the 1990's, with both the DCA and the CBDT initiating their own standard setting programs.

Culture and social context are seen to be important in all three phases of the setting up of the standard setting process of the ICAI. An important accounting profession is expected in India, together with strong statutory and Government control of accounting. The setting up of the standard setting process is consistent with this. The standard setting process is seen to increase the importance of the ICAI in regulating accounting and financial reporting, although, perhaps, not as effectively as the ICAI would have liked. In the 1990's, direct Government involvement in accounting standard setting is seen to increase significantly, which is again consistent with the culture of India.

The whole standard setting process is also seen to be explicitly political. The system chosen by the ICAI to promulgate accounting standards is one of due process and the accounting standards that are promulgated are the result of the interactions of all the parties interested in accounting within this due process system. The main parties interested in standard setting are identified to be the Government and the corporate sector.

Finally, the colonial history of India is seen to be important in influencing accounting change in India after independence. The standard setting process chosen by the ICAI is based on similar systems used by the accounting profession in the UK and by the IASC which result in accounting standards which are determined by interactions between all the parties involved in accounting.

Chapter 12

The Setting Up of the Institute of Cost and Works Accountants in India and Cost Accounting and Cost Auditing in India

Introduction

As discussed in chapter 10, the ICAI was set up soon after independence with the co-operation of the Ministry of Commerce and the Indian Accountancy Board (IAB). Before independence the British Government had set up the Indian Accountancy Board (IAB) to advise the Governor General on the regulation of the auditing profession. At independence, the IAB worked closely together with the Government of India to set up the ICAI in 1949.

Unlike the ICAI, which was set up very quickly after independence, the ICWAI took a little longer to be set up as a statutory body. Cost accounting had developed in the war years before independence. Cost accounting work had been shared among registered accountants (who later became chartered accountants) and cost accountants, who were members of a privately run cost accounting institute, called the Institute of Cost and Works Accountants of India (ICWAI), which had been set up in 1944. In 1959 the privately run ICWAI was set up as a statutory body under its own act of parliament. Subsequent to this, cost accounting and cost auditing requirements were promulgated.

The setting up of the Institute of Cost and Works Accounting of India and the promulgation of the cost accounting and cost auditing requirements in India is discussed below.

The setting up of the Institute of Cost and Works Accountants of India

The ICWAI was first set up as a privately run company in 1944, in response to demand from the defence sector in the war. During the war, the defence sector suffered from profiteering by the corporate sector. Prices in the defence industry were usually calculated on a cost plus basis and therefore some companies inflated their prices arguing that their costs had increased. Due to this war profiteering, the Government needed a mechanism for checking the costs of defence products. This was initially provided by a few British cost accountants but this did not meet the need for cost accounting services. Many more cost accountants were needed and the British Institute of Cost and Works Accountants was asked to open a branch in India to train cost accountants in India. This did not materialise and hence senior Indian cost accountants, who had qualified with the British Institute of Cost and Works Accountants, were asked by the Government to set up an institute to train Indian cost accountants. This led to the setting up of the ICWAI as a privately run company in 1944 to train cost accountants to work in the defence industry. *(interviews with senior member of the accounting profession on 17th November 1998; interview with senior Indian academic on 7th November 1998; Kapadia G.P., 1972, Chapter 6)*

After independence, cost accounting gradually became recognised as important for the economic development of the country. This led, in the 1950's, to the Government initiating the setting up of the ICWAI as a statutory body using legislation promulgated through the parliamentary system. This was done in two stages. Firstly in 1956, the Government gave administrative recognition to the privately run ICWAI, pending legislation for the setting up of a statutory institute of cost accountants. Then, in 1959, the ICWAI was then set up as a statutory body, under the Cost and Works Accountants Act of 1959, which was similar to the Chartered Accountants Act 1949. *(interviews with senior member of the accounting profession on 17th November 1998; interview with senior Indian academic on 7th November 1998; Kapadia G.P., 1972, Chapter 6; Iyer R.S.V., Chartered Accountant, vol iii, October 1954, pages 169 to 173; Chopra S.P., Chartered Accountant, vol viii, May 1959, pages 317 to 320; Bhushan B.S.N., Chartered Accountant, vol vii, May 1959, pages 327 to 329; Haldia D.D., Chartered*

Accountant, vol ix, February 1961, pages 321 to 324; Dalal R.R., Chartered Accountant, vol xxi, September 1972, pages 161 to 165)

The Cost and Works Accountants Act was drafted by the Government and introduced into the Rajya Sabha on the 24th September 1958, as the Cost and Works Accountants Bill 1958. The Bill was debated in both the Rajya Sabha and the Lok Sabha on 20th and 22nd December 1958 respectively and referred to a joint select committee of both houses of parliament. The joint select committee reviewed the Cost and Works Accountants Bill from December 1958 to February 1959, reporting back to Parliament on 7th February 1959. *(Report of the joint select committee report on the Cost and Works Accountants Bill 1958, 1959, pages iii to xiv).* The bill, as amended by the select committee, was then debated in both houses of parliament before receiving assent on 28th May 1959. The privately run ICWAI was dissolved in 1959 and the ICWAI was set up under the provisions of the Cost and Works Accountants Act 1959.*(Kapadia G.P., 1972, Chapter 6)*

The immediate reaction phase to the setting up of the ICWAI lasted from 1959 to 1965. Soon after the ICWAI was set up in 1959, there were interactions between the ICAI and the ICWAI on the issue of mutual recognition. Then in 1960 and 1965, the Government introduced the requirement for certain industries to maintain cost accounting records and introduced the requirement for certain industries to have cost audits, which were to be undertaken by members of the ICWAI. *(Kapadia G.P., 1972, Chapter 6)*

The setting up of the ICWAI and the reaction to the setting up of the ICWAI is analysed below.

Analysis of the setting up of the Institute of Cost and Works Accountants in India and cost accounting and cost auditing in India

The setting up of the ICWAI can be broken down into source, diffusion and reaction phases, using the theoretical framework proposed in chapter 3, as follows:

The Source Phase

The setting up of the ICWAI can be traced to the need for cost accounting during the second world war. The war effort created a large demand in the defence industry and led to large price increases in the sector. Pricing was largely calculated on a cost plus basis and this led to the need for Government to check the costing policies and practices of companies in the defence sector. This need was met by a privately run ICWAI, which was set up in 1944, to train cost accountants to work in the defence sector. Thus cost accounting played an important role in helping the Government combat profiteering by the corporate sector in the second world war. *(interviews with senior member of the accounting profession on 17th November 1998; interview with senior Indian academic on 7th November 1998; Kapadia G.P., 1972, Chapter 6)*

After independence, the Government continued to recognise the need for cost accounting for the following reasons:

- to help provide effective systems of cost control in, and ensure the efficient working of, nationalised undertakings.
- to provide information on the optimum utilisation of labour and material resources in both the public and the private sector, which was vital for industrial development.
- to help the efficient use of material resources, which were in short supply. This would also help to reduce imports of raw materials which would, in turn, help reduce the foreign exchange requirements of the country.
- to reduce prices in the economy which would help consumers, particularly the poor in the country
- to provide accurate information on costs, productivity and wages in the private sector. Trade unions and other employee representatives were

critical of the corporate sector's arguments against rewarding employees on the basis of low productivity and increasing costs. Employee representatives argued that the corporate sector's arguments could not be substantiated or disproved due to the lack of costing information available. Thus cost accounting was important to ensure that the social ideal of equity and fairness in India was upheld. It was expected that cost accounting would help ensure that workers were fairly treated and fairly rewarded for their efforts and that rewards did not just accrue to the owners of businesses.

(interviews with senior member of the accounting profession on 17th November 1998; interview with senior Indian academic on 7th November 1998; Kapadia G.P., 1972, Chapter 6; Report of the joint select committee report on the Cost and Works Accountants Bill 1958, 1959, pages iii to xiv; Indian Parliamentary debates on the Cost and Works Accountants Bill 1958 on 9th December 1958, 10th December 1958, 19th February 1959; Iyer R.S.V., Chartered Accountant, vol iii, October 1954, pages 169 to 173; Chopra S.P., Chartered Accountant, vol vii, May 1959, pages 317 to 320; Bhushan B.S.N., Chartered Accountant, vol vii, May 1959, pages 327 to 329; Haldia D.D., Chartered Accountant, vol ix, February 1961, pages 321 to 324; Dalal R.R., Chartered Accountant, vol xxi, September 1972, pages 161 to 165)

From the above, it can be seen that, once again, economic concerns were the primary reason for the setting up of the ICWAI as a statutory body. The Government perceived that cost accounting would help in rapid economic development and would help promote cost consciousness and efficiency in both the public and private sector. In addition, the political ideals at the time, of economic development alongside social justice and fairness, also contributed to the need for cost accounting which would help in evaluating whether employees were being fairly rewarded by the corporate sector or not.

Unlike in the other changes to the accounting system, an intrusive event was important in stimulating change to the accounting system. This was the war and the need of the Government to combat war profiteering in the defence sector. The need for cost accounting also arose from general Government concerns to improve the economy and thus, both an intrusive event and general Government concerns for economic and industrial development combined to generate the need for cost accounting in India in the 1950's.

The diffusion Phase

The start of the diffusion phase can be traced to the second world war and the setting up of the privately run ICWAI in 1944. The diffusion phase lasted until 1959 when the ICWAI was set up as a statutory body under The Cost and Works Accountants Act, 1959 and the privately run ICWAI was dissolved.

During the war, Government defence factories were working to their full capacity and hence many Government contracts were placed with private contractors. These contracts were usually on a cost plus basis. The private contractors started to charge very high prices for defence products, claiming that they were facing high costs. This was disputed by the Government, who needed cost accountants to undertake investigations into the cost structures of the contractors. *(Kapadia G.P., 1972, Chapter 6; interviews with senior member of the accounting profession on 17th November 1998; interview with senior Indian academic on 7th November 1998)*

Initially, the services of a few foreign experts were requisitioned, who with the help of a few locally available cost accountants, introduced costing systems into Government ordinance factories and investigated private contractors. However the demand for cost accountants could not be met by the foreign experts and the training of Indian cost accountants became essential. *(Kapadia G.P., 1972, Chapter 6; interviews with senior member of the accounting profession on 17th November 1998; interview with senior Indian academic on 7th November 1998)*

An attempt was made to open a branch of the British Institute of Cost and Works Accountants to train Indian cost accountants but this was not successful. The demand for training Indian accountants was, therefore, met by senior Indian accountants who had qualified with the British Institute of Cost and Works Accountants. The Government met with these Indian cost accountants and requested them to set up an institute to train Indian cost accountants. This led to the setting up of the Institute of Cost and Works Accountants of India (ICWAI) as a private company by senior Indian cost accountants in 1944. The role of the privately run ICWAI was to train cost accountants to work in the defence industry during the second world war. Thus at independence, a privately run

ICWAI was in existence, which facilitated the development of the cost accounting profession after independence. *(Kapadia G.P., 1972, Chapter 6; interviews with senior member of the accounting profession on 17th November 1998; interview with senior Indian academic on 7th November 1998)*

After independence, the priority of the Indian Government was rapid economic development. This was to be achieved through the development of a large public sector and a controlled private sector. Cost accounting was seen as an important tool, which would help promote economic efficiency and growth, particularly in the public sector, but also in the private sector. Indeed many government departments and bodies such as the tariff commission and the estimates committee of the parliament, argued that cost accountants were vital to help eradicate waste and inefficiency in the public sector and profiteering in the private sector. These calls gathered momentum, and in the 1950's, led to the promulgation of the Cost and Works Accountants Act 1959, which changed the privately run ICWAI into a statutory body. The privately run ICWAI was dissolved and its assets transferred to the newly formed statutory ICWAI. *(interviews with senior member of the accounting profession on 17th November 1998; interview with senior Indian academic on 7th November 1998; Kapadia G.P., 1972, Chapter 6; Report of the joint select committee report on the Cost and Works Accountants Bill 1958, 1959, pages iii to xiv; Indian Parliamentary debates on the Cost and Works Accountants Bill 1958 on 9th December 1958, 10th December 1958, 19th February 1959; Iyer R.S.V., Chartered Accountant, vol iii, October 1954, pages 169 to 173; Chopra S.P., Chartered Accountant, vol vii, May 1959, pages 317 to 320; Bhushan B.S.N., Chartered Accountant, vol vii, May 1959, pages 327 to 329; Haldia D.D., February 1961, Chartered Accountant, vol ix, pages 321 to 324; Dalal R.R., Chartered Accountant, vol xxi, September 1972, pages 161 to 165)*

Before the ICWAI could be formed as a statutory body, amendments to the wording of the Chartered Accountants Act 1959 were needed. The Chartered Accountants Act stated that the role of the ICAI was to regulate accounting and changes were needed to change this so that the role of the ICAI was restricted to the regulation of financial accounting and auditing. These changes were promulgated using the Chartered Accountants (Amendment) Bill 1958. This change to the Chartered Accountants Act 1949 can be regarded as part of the reaction phase of the setting up of the ICAI in 1949. *(Kapadia G.P., 1972, Chapter 6)*

Both intra-system activity (interactions between institutions within the accounting system) and trans-system activity (interactions between the accounting system and neighbouring systems) are seen in the diffusion phase of the change. Intra-system activity is seen between the Government, the ICAI; and the ICWAI and accounting regulation and trans-system activity is seen between the corporate sector and the parliamentary system and accounting regulation. Both intra-system activity and trans-system activity are discussed below.

Intra-system

Interactions between the accounting profession and cost accounting

The ICWAI and cost accounting

Cost accounting had started in the second world war and a privately run ICWAI was set up in 1944 to train cost accountants to work in industry, mainly in the defence industry. This privately run institute was set up after meetings between the Government and the few cost accountants in India, who had mostly trained in the UK with the British Institute of Cost and Works Accountants. The Government was in need of cost accountants to check the cost records of companies who were charging high prices and profiteering from war shortages. Thus the interests of the Government and senior cost accountants coincided, leading to the first steps in developing a cost accountancy profession in India. *(Kapadia G.P., 1972, Chapter 6)*

After the war, the ICWAI continued to promote cost accounting and to train cost accountants. They promoted the view that cost accounting was important for all manufacturing concerns and not just the defence industry in times of war. There were interactions between the privately run ICWAI and the Government, to persuade the Government that cost accounting was vital and that an independent cost accounting profession was needed and appropriate. *(Kapadia G.P., 1972, Chapter 6; interviews with senior member of the accounting profession on 17th November 1998; interview with senior Indian academic on 7th November 1998)*

Despite opposition from the ICAI, the view that cost accounting was important was accepted by the Government since this fitted in with their perception that cost accounting was vital for economic development. This view grew with the development of the public sector and in 1959, the ICWAI was set up as a statutory body, under an act of parliament promulgated through the parliamentary system. This was very much in line with the wishes of the ICWAI, as this increased their status, profile and influence. *(Kapadia G.P., 1972, Chapter 6; Report of the joint select committee report on the Cost and Works Accountants Bill 1958, 1959, pages iii to xiv; Indian Parliamentary debates on the Cost and Works Accountants Bill 1958 on 9th December 1958, 10th December 1958, 19th February 1959; Iyer R.S.V., Chartered Accountant, vol iii, October 1954, pages 169 to 173; Chopra S.P., Chartered Accountant, vol vii, May 1959, pages 317 to 320; Bhushan B.S.N., Chartered Accountant, vol vii, May 1959, pages 327 to 329; Haldia D.D., Chartered Accountant, vol ix, February 1961, pages 321 to 324; Dalal R.R., Chartered Accountant, vol xxi, September 1972, pages 161 to 165)*

The process to set up the ICWAI was similar to the process used to set up the ICAI in 1949 and the ICWAI was set up using the same model as the ICAI. The Cost and Works Accountants Act 1959 was similar to the Chartered Accountants Act 1949 and hence the structure of the ICWAI and the cost accounting profession was similar to the ICAI and the chartered accounting profession. *(Kapadia G.P., 1972, Chapter 6)*

The Cost and Works Accountants Bill 1958 covered the following areas, most of which were similar to the Chartered Accountants Act 1949:

- Incorporation of the institute,
- Definition of cost accountants Fellows and associates
- Certificates of practice
- Constitution of the Council of the Institute
- Elections to the Council
- President and Vice president
- Functions of the Council
- Committees of the Council
- Register of member of the institute
- Misconduct
- Regional Councils
- Penalties for members not following the rules of the Institute
- Dissolution of the existing, privately run ICWAI

(The Cost and Works Accountants Act 1959, Government of India)

The management of the affairs of the ICWAI was to be entrusted to a Council consisting of elected representatives of the Institute and nominees of the central government. The institute was to be an autonomous body, free from Government control except in respect of specified matters. The Government would retain overriding powers to issue directions to the ICWAI but stated that Government interference in the affairs of the Institute would be minimal and only when absolutely necessary. The privately run ICWAI would be dissolved and all assets and liabilities transferred to the newly formed statutory ICWAI. *(Kapadia G.P., 1972, Chapter 6; Report of the joint select committee report on the Cost and Works Accountants Bill 1958, 1959, pages iii to xiv; Indian Parliamentary debates on the Cost and Works Accountants Bill 1958 on 9th December 1958, 10th December 1958, 19th February 1959)*

The Cost and Works Accountants Bill 1958 was initially debated in both the Rajya Sabha and the Lok Sabha in December 1958 and referred to a joint select committee of both houses of parliament. The joint select committee held six sittings from 24th December 1958 to January 1959. The committee requested all recognised institutes of cost accountants and chartered accountants as well as representatives of trade and industry to submit memoranda, incorporating their views on the provisions of the bill. The committee received thirteen representations from parties interested in the bill. The parties submitting representations on the bill are given in appendix 21. The joint committee then invited some parties to give oral evidence to the committee. The parties giving oral evidence to the joint committee are given in appendix 22.

The main changes made to the Cost and Works Accountants Bill at the joint select committee stage included:

- the terms of office for the vice-president and the president were reduced from three years to one year. *(Clause 12 of the select committee report on the Cost and Works Accountants Bill, 1958)*
- the number of elected representatives on the Council of the ICWAI was increased from eight to twelve to give greater weight in the Council to the elected representatives of the members of the ICWAI. *(Clause 12 of the select committee report on the Cost and Works Accountants Bill, 1958)*
- the abolition of the distinction between members in practice and members not in practice *(Clause 7 of the select committee report on the Cost and Works Accountants Bill, 1958)*

- the power to hear cases of misconduct of a serious nature and all appeals against the decisions of the ICWAI was vested in the high courts, rather than with the government *(Clauses 21 and 33 of the select committee report on the Cost and Works Accountants Bill, 1958)*

All other changes made by the select committee were comparatively minor.

The ICAI was against the setting up of the ICWAI as a separate, statutory professional body as discussed in the next section. The privately run ICWAI put forward the following arguments in support of developing a separate cost accounting profession:

- cost accounting was very different from financial accounting and therefore it was more appropriate to have a separate institute to regulate cost accounting.
- chartered accountants only studied cost accounting as a subsidiary subject and this was not sufficient for them to have enough costing expertise to qualify as cost accountants.
- chartered accountants were more focused on financial accounting and auditing and hence would not have the motivation to devote enough time to the vast task of cost accounting needed in industry.
- the introduction of a new cost accounting profession headed by a separate institute would increase employment opportunities in the country.
- there would be administrative costs in joining two institutes together which was unnecessary.
- the members of the ICWAI were in favour of being separate from the ICAI and hence would resist the bringing together of both institutes, which would make the joining to the two institutes difficult.
- chartered accountants had been criticised on the grounds of lack of independence from the auditing profession and the corporate sector. It would be better to have a separate institute for cost accounting, which would introduce a rival to the ICAI and hopefully lead to improvements in the standards of the accounting profession.

  (Report of the joint select committee report on the Cost and Works Accountants Bill 1958, 1959, pages iii to xiv; Indian Parliamentary debates on the Cost and Works Accountants Bill 1958 on 9th December 1958, 10th December 1958, 19th February 1959)

These arguments were made within the parliamentary process used to promulgate the Cost and Works Accountants Act 1959 and directly to Government in meetings with Government departments such as the Ministry of Commerce and the Department of Company Law Administration. The Government was

persuaded by the arguments of the privately run ICWAI, which very much fitted in with the Governments own views, and hence the statutory ICWAI was set up in 1959, in line with the wishes of the ICWAI and against the wishes of the ICAI.

From the above, it can be seen that the privately run ICWAI was important in the setting up of the ICWAI as a statutory body. The privately run ICWAI was set up in 1944 through the efforts of senior cost accountants and the Government. After independence, the senior cost accountants who ran the private ICWAI, argued for the need of cost accounting and a statutory body, separate from the ICAI, to regulate cost accounting. This fitted in with the perception held by Government that cost accounting was important for economic development and that this body should be separate from the ICAI. The Government initiated the process which led to the setting up of the statutory ICWAI in 1959, despite opposition from the ICAI. Thus the privately run ICWAI was very influential in the setting up of the statutory ICWAI.

The ICAI and cost accounting

The ICAI was very much against the setting up of the ICWAI and opposed all moves to set up the ICWAI as a statutory body in 1959. When it became apparent that it was likely that the ICWAI would be set up as a statutory body, the ICAI held many meetings with the Government, including inviting the Secretary of the Ministry of Commerce to attend one of their council meetings, to discuss the issue of the ICWAI.

The ICAI wanted assurances from the Government that the status, function and powers of the ICAI would not be affected by the setting up of the ICWAI. They argued that, since many chartered accountants undertook cost accounting work, they would be detrimentally affected by the setting up of the ICWAI. The ICAI argued that cost accounting should be added to the role of the ICAI since the Chartered Accountants Act 1949 gave them the role of regulating all accounting, not just financial accounting. If this was not acceptable to the Government, the ICAI argued that, at the very least, the rights of chartered accountants should be protected and that they should be allowed to have automatic membership of the

ICWAI. The arguments made by the ICAI to support their case included the following:

- chartered accountants did study cost accounting and hence were qualified to undertake cost accounting work. Therefore, they should be allowed to become automatic members of the ICWAI and /or perform cost accounting work in their own right.
- some chartered accountants, both senior and junior, had cost accounting experience and hence should not be stopped from continuing this work. In fact, the ICAI identified three categories of chartered accountants who should automatically become members of the ICWAI. These were
  - senior accountants who had relevant costing experience
  - junior accountants who had relevant costing experience
  - all chartered accountants who had passed the costing examination of the ICAI

  This was informally accepted by Government but not included in the Cost and Works Accountants Act 1959. This was one of the main issues that was negotiated in the reaction phase to the change.
- there was no need for two accounting institutes, which would only increase bureaucracy and confusion in the accounting system
- the ICAI had experience and competence in the field of accountancy. Cost accounting was a subset of accounting and hence the ICAI was in a better position to deal with cost accounting than the relatively new ICWAI.
- the ICAI argued that cost accounting was not being taken seriously by the corporate sector. It was more likely that cost accounting would be introduced into the corporate sector if it was regulated by the ICAI, a well established professional body which had a long and reputable history
- the ICAI argued that assurances should be given that, if the ICWAI was set up, its activities would be restricted to a limited purpose. For example, limited to cost accounting in the public sector.

(Report of the joint select committee report on the Cost and Works Accountants Bill 1958, 1959, pages iii to xiv; Indian Parliamentary debates on the Cost and Works Accountants Bill 1958 on 9th December 1958, 10th December 1958, 19th February 1959; Kapadia G.P., 1972, Chapter 6)

The Government could not, and indeed did not want to, give such assurances but did state that the ICAI should not worry about the setting up of the ICWAI, although they did not make any specific promises to the ICAI. They also considered carefully the argument made by the ICAI that the Chartered Accountants Act 1949 gave them the right to undertake all accountancy work.

The Ministry of Commerce consulted with the Ministry of Law on this. The Ministry of Law indicated that this was indeed the case and that the law would need to be changed for the ICWAI to be set up as a statutory body to regulate cost accounting. *(Kapadia G.P., 1972, Chapter 6)*

This led to the promulgation of the Chartered Accountants (Amendment) Bill 1958, to change the Chartered Accountants Act 1949. The Act was changed to read that members of the ICAI would undertake "financial accounting and auditing" rather than "accounting". The Council of the ICAI raised objections to this change, both to the Government representatives on the Council, in meetings with the Government outside the parliamentary process and within the parliamentary process. The ICAI argued strongly against these changes to the Chartered Accountants Act but were not successful. *(Kapadia G.P., 1972, Chapter 6)*

The ICAI also tried to have the following provisions included in the Chartered Accountant Act and the Cost and Works Accountants Act:

- the Cost and Works Accountants Act should include a clause, allowing chartered accountants to undertake cost accounting work
- the Chartered Accountants Act should be amended to include cost accounting work as part of the work that chartered accountants were allowed to undertake

None of these provisions were promulgated, very much against the will of the ICAI. Indeed, the ICAI was greatly concerned by the setting up of the ICWAI as a statutory body. One of their greatest fears was that the Government had a hidden agenda when it promoted the setting up of the ICAI. This was to reduce the power of the ICAI and exert more control over the ICAI. Though this was denied by the Government, it is expected that this may well have been true. *(Kapadia G.P., 1972, Chapter 6)*

From the above, it can be seen that the ICAI were very concerned about the setting up of the ICWAI and opposed this in many ways. These included

- making representation to the government representatives on the Council of the ICAI,

- inviting senior members of the Government to meeting of the Council of the ICAI,
- holding other meetings with Government officials, in particular, officials of the Ministry of Commerce,
- making representations to the select committee set up to review the Cost and Works Accountants Act
- making representations to members of parliament to present their case in the parliamentary debates on the act.

However, despite the activities, argument and concerns of the ICAI, they were not successful in influencing the Government or the Cost and Works Accountants Act and were not able to prevent the setting up of the ICWAI. Instead, the ICAI had to accept informal assurances from the Government that their interests would not be affected

Interactions between the Government and cost accounting

The Government, in particular the Ministry of Commerce, was very important in the process of accounting change, and the setting up of the ICWAI in several ways.

As outlined above, the Government was involved in the setting up of the privately run ICWAI in 1944. It is expected that if the Government had not met with cost accountants in India and initiated proposals to set up a privately run institute, the institute may well not have been set up.

The Government was also instrumental in the setting up of the ICWAI as a statutory institute in 1959. There were many calls from various government departments in the 1950's for the need for cost accounting and an institute to train and regulate cost accountants. These included calls from the tariff commission and the estimates committee of parliament, who argued strongly for the need for cost accounting. The Government accepted the need for cost accounting and decided that a statutory body was needed to promote and regulate cost accounting. *(Report of the joint select committee report on the Cost and Works Accountants Bill 1958, 1959, pages iii to xiv; Indian Parliamentary debates on the Cost and*

Works Accountants Bill 1958 on 9th December 1958, 10th December 1958, 19th February 1959; Kapadia G.P., 1972, Chapter 6)

The Ministry of Commerce then met with all parties interested in the cost accounting profession and this included members of the ICAI, members of the privately run ICWAI and the corporate sector before deciding to change the privately run ICWAI into a separate statutory body to regulate cost accounting. *(Kapadia G.P., 1972, Chapter 6; interviews with senior member of the accounting profession on 17th November 1998; interview with senior Indian academic on 7th November 1998)*

In order to be able to set up the ICWAI, the Government needed to amend the Chartered Accountants Act 1949. Changes to the wording of the Chartered Accountants Act were needed and these changes were included in the Chartered Accountants (Amendment) Bill 1958. This Amendment Bill was steered through the parliamentary system by the Government and there was little opposition to the Bill, except by the ICAI. *(Kapadia G.P., 1972, Chapter 6)*

Before this, in 1956, the Government had announced that the ICWAI would be set up as a statutory body under legislation promulgated through the parliamentary system. The Government gave official recognition to the privately run ICWAI at this time, pending the legislation which was required to set up the ICWAI as a statutory body. The Government then drafted the Cost and Works Accountants Bill 1958, which would enable the setting up of the ICWAI as a statutory body and steered the Bill through the parliamentary system. *(Kapadia G.P., 1972, Chapter 6)*

From the above, it can be seen that the Government was, probably, the most important party in the setting up of the ICWAI, since they initiated the setting up of the privately run ICWAI, gave official recognition to the privately run ICWAI, initiated the setting up of the ICWAI as a statutory body, drafted the Cost and Works Accountants Bill1958, steered the Bill through parliament and negotiated with all the parties interested in the Bill.

Trans-system activity

Interactions between the corporate sector and cost accounting

The corporate sector too was involved in the process for setting up the ICWAI. In general, the corporate sector was against the setting up of another accounting profession that might introduce regulations, which the corporate sector would have to follow. Indeed, the setting up of the ICWAI was likely to affect the corporate sector significantly if regulations were promulgated to make cost accounting mandatory. This was not proposed at the time of setting up the ICWAI but was a possibility in the future.

The corporate sector made their views known, mainly through trade associations and chambers of commerce such as the federation of industry and chambers of commerce of India. The views of the corporate sector were given in meetings with the Government, at the select committee review of the Cost and Works Accountants Bill and in the parliamentary debates on this bill. The corporate sector argued that no specialist cost accountants were needed and certainly no separate cost accounting institute was needed. *(Report of the joint select committee report on the Cost and Works Accountants Bill 1958, 1959, pages iii to xiv; Indian Parliamentary debates on the Cost and Works Accountants Bill 1958 on 9th December 1958, 10th December 1958, 19th February 1959; Kapadia G.P., 1972, Chapter 6)*

The corporate sector was unsuccessful in arguing against the ICWAI since the Government considered cost accounting and the setting up of the ICWA to be vital for economic development.

Interactions between Parliament and cost accounting

Parliament had the opportunity to influence the setting up of the ICWAI as the ICWAI was set up under statutory legislation, the Cost and Works Accountant Act 1959, which was promulgated through the parliamentary system. This included

- drafting of the bill by the Government and the introduction of the Bill into Parliament by the Government
- initial debates on the Bill in Parliament
- referral of the Bill to a joint select committee of both houses of parliament
- a joint select committee review of the Bill, leading to revision of the Bill
- debate of the revised Bill in both houses of parliament.

(Report of the joint select committee report on the Cost and Works Accountants Bill 1958, 1959, pages iii to xiv; Indian Parliamentary debates on the Cost and Works Accountants Bill 1958 on 9th December 1958, 10th December 1958, 19th February 1959; Kapadia G.P., 1972, Chapter 6; Chapter 4)

All parties interested in the bill had the opportunity to present their point of view within the parliamentary process, both at select committee stage and through members of Parliament in the parliamentary debates in the bill. *(Kapadia G.P., 1972, Chapter 6; interviews with senior member of the accounting profession on 17th November 1998; interview with senior Indian academic on 7th November 1998)*

The main changes made to the bill at the select committee stage included:

- the abolition of the distinction between members in practice and members not in practice *(Clause 7 of the select committee report on the Cost and Works Accountants Bill, 1958)*
- the power to hear cases of misconduct and appeals against the decisions of the ICWAI was vested in the high courts, rather than with the government *(Clauses 21 and 33 of the select committee report on the Cost and Works Accountants Bill, 1958)*
- the terms of office for the vice-president and the president were reduced from three years to one year. *(Clause 12 of the select committee report on the Cost and Works Accountants Bill, 1958)*
- the number of elected representatives on the Council of the ICWAI was increased from eight to twelve. *(Clause 12 of the select committee report on the Cost and Works Accountants Bill, 1958)*

Thus Parliament did influence some of the key provisions of the Cost and Works Accountants Bill 1959.

The Reaction Phase

There was an initial reaction phase to the setting up of the ICWAI, which took place from 1959 to 1965, immediately after the setting up of the institute. In this period, there were several issues, which were considered, and several regulations promulgated which directly related to cost accounting. There were three main developments in the reaction phase to the setting up of the ICWAI ;

- the issue of mutual recognition between the two institutes. In particular, there was consideration of whether chartered accountants should automatically be allowed to become members of the ICWAI and whether cost accountants could automatically become members of the ICAI.
- the promulgation of regulations requiring certain industries to keep cost accounting records.
- the promulgation of regulations requiring certain industries to have cost audits.

The reaction phase comprises of both intra-system activity and trans-system activity. Intra system activity occurred between the ICWAI, the ICAI and the Government and cost accounting. Trans-system activity occurred between Parliament and the corporate sector and cost accounting. This is discussed below.

Intra-system activity

The accounting profession and cost accounting

Interactions between the ICAI and the ICWAI and cost accounting

Both the ICAI and the ICWAI were important in the reaction phase to the setting up of the ICWAI and interactions between these two institutes determined how the three main issues were finally incorporated into the accounting system. These are discussed below.

The issue of mutual recognition

The ICAI was very active in the reaction phase of the setting up of the ICWAI. The interests of the ICAI were very much affected by the setting up of another professional accounting institute and hence they undertook lobbying activity to try to minimise the impact of the new institute. The main issue that needed to be addressed was that of mutual recognition i.e. whether chartered accountants could become members of the ICWAI and whether cost accountants could become members of the ICAI.

During the promulgation of the Cost and Works Accountants Act 1959, the Council of the ICAI, had led a deputation to the Ministry of Commerce to urge that measures be introduced to safeguard the interests of chartered accountants who undertook predominantly cost accounting work. The ICAI identified three groups of chartered accountants who, in their opinion, should be able to practice as cost accountants:

- senior practising chartered accountants who had sufficient costing experience.
- chartered accountants who had been practising as cost accountants when the bill was promulgated.
- all other chartered accountants who had passed the costing examination of the ICAI, even if they did not have practical costing experience.

(Kapadia G.P., 1972, Chapter 6; Indian Parliamentary debates on the Cost and Works Accountants Bill 1958 on 9th December 1958, 10th December 1958, 19th February 1959)

The Ministry accepted this request but did not formally include these groupings in the Cost and Works Accountants Act. Instead, the Ministry of Commerce informally assured the ICAI that these categories of chartered accountants would be able to undertake cost accounting work after the Cost and Works Accountants Act was promulgated. *(Kapadia G.P., 1972, Chapter 6)*

After the promulgation of the Cost and Works Accountants Bill 1959, the Ministry of Commerce sent a letter to the ICAI, informing them that the first two categories of chartered accountants would be allowed to practice as cost accountants. However, the third category would need to be negotiated with the

ICWAI. This may have been in response to requests by the ICWAI, that the role of chartered accountants should be reduced in the field of cost accounting. *(Kapadia G.P., 1972, Chapter 6)*

The ICAI was unhappy with this situation and met with the Ministry of Commerce to try and overturn their decision. They felt that the interests of the ICAI and the employment opportunities of individual chartered accountants was being reduced. Indeed, the ICAI argued that cost accounting had always been one of the specific functions of chartered accountants and that this should remain, despite the setting up of the ICWAI as a statutory body. They also argued that all chartered accountants should automatically become members of the ICWAI. *(Kapadia G.P., 1972, Chapter 6; Kapadia G.P., 1972, Chapter 6; Indian Parliamentary debates on the Cost and Works Accountants Bill 1958 on 9th December 1958, 10th December 1958, 19th February 1959)*

The ICWAI too met with the Government, to argue that the role of chartered accountants in cost accounting should be limited and that there should be no automatic membership of the ICWAI for any chartered accountants. The ICWAI also argued that senior cost accountants should be allowed, automatically, to become members of the ICAI. This was opposed by the ICAI. The ICAI did not want to enter into any reciprocal arrangements with the ICWAI and did not want cost accountants to be given any membership or other rights in the ICAI. Indeed, there was a significant amount of antagonism between the two institutes, who both saw themselves as in competition with each other and were concerned that their interests and status would be affected by each other. *(Kapadia G.P., 1972, Chapter 6; (Kapadia G.P., 1972, Chapter 6; Indian Parliamentary debates on the Cost and Works Accountants Bill 1958 on 9th December 1958, 10th December 1958, 19th February 1959)*

The Government, after listening to both parties, again recommended that the first two categories of chartered accountants should have the right to undertake cost accounting work but that the third category would not automatically be given the right to undertake cost accounting work. This would have to be negotiated between the two institutes. *(Kapadia G.P., 1972, Chapter 6)*

The ICAI was not happy with this and continued to lobby the Government for the right of all chartered accountants with appropriate experience to undertake cost accounting work but was not successful. The Government would not give this right to all chartered accountants and insisted that this should be discussed by the two institutes themselves. The Government recommended that a negotiating committee of members of the ICAI and the ICWAI be set up to discuss this issue. *(Kapadia G.P., 1972, Chapter 6)*

Following this directive from the Government, the ICAI and ICWAI were forced to set up a negotiating committee to discuss the issue of mutual recognition. In the committee, the ICAI argued that senior chartered accountants and other chartered accountants with "relevant experience" should automatically be allowed to undertake cost accounting work. This was accepted by the negotiating committee but the committee could not agree on what the definition of "relevant experience" should be. In addition, the ICAI wanted all chartered accountants who had passed the costing examination of the ICAI to become automatic members of the ICWAI. This was not acceptable to the ICWAI. The ICWAI wanted their senior members to have automatic rights of membership to the ICAI and this was unacceptable to the ICAI. As agreement could not be reached by the negotiating committee on these issues, it was decided that the best way forward was present the views of both the institutes to the Government and let the Government make the final decision on all areas of contention. *(Kapadia G.P., 1972, Chapter 6)*

After protracted negotiations between the two institutes and Government involvement, the following proposals were agreed:

- all chartered accountants with more than ten years accounting experience as at 1 January 1959, should qualify for membership of the ICWAI if they had cost accounting experience
- the ICAI wanted all members who had gained ten years experience at any time in the future to automatically become members of the ICWAI. The ICWAI only wanted those members who had ten years experience at 1 January 1959 to become automatic members of the ICWAI.

  A compromise was reached with Government approval, that the concession for chartered accountants to become automatic members of

the ICWAI after ten years experience would not remain open forever, but would remain for three more years.

- the decision on whether membership of the ICWAI was given to chartered accountants was left to the ICWAI but a right of appeal was given to the Government
- the ICWAI wanted reciprocal arrangements for senior cost accountants to become members of the ICAI but this not wanted by the ICAI. This was not given, on the grounds that cost accountants did not have to undergo an articleship whereas this was mandatory for chartered accountants. This was accepted by the Government and cost accountants were not given the right to become members of the ICAI.

(Kapadia G.P., 1972, Chapter 6)

After agreement on the above issues had been reached and a joint memorandum sent to the Government by the both the ICAI and the ICWAI confirming agreement, the ICAI reconsidered their position. The ICAI wanted to reopen negotiation with the ICWAI on the issue of mutual recognition. This was not acceptable to the ICWAI, who argued that negotiations could not be continually reopened at the whim of the ICAI. At this point, the Government intervened and declared that it too was not agreeable to further negotiations. The ICAI had to accept this and accept that no more negotiations on the issue of mutual recognition could take place. *(Kapadia G.P., 1972, Chapter 6)*

From the above, it can be seen that interactions between the ICAI and the ICWAI, together with the Government, determined how the relationship between the two institutes would work in practice and how contentious issues would be resolved. The two institutes negotiated on the issue of mutual recognition and both institutes promoted their own interests, as expected. However, when there were disagreement between the two institutes which could not be resolved, the Government made the final decisions and also acted to ensure that agreements were kept and not reopened and continually renegotiated.

Cost accounting records.

Once the ICWAI was set up as a statutory body, the Government introduced the requirement for all companies in particular industries to keep cost accounting records. This requirement was introduced into Section 209 (1)(d) of the

Companies Act 1956 by the Companies (Amendment) Act 1960. Keeping cost accounting records meant that companies were required to keep books of account in a way that the costs of production and the cost of sales during the financial of the year of the company could be properly calculated and that prescribed elements of costs could be identified. The main cost accounting regulations are given in appendix 23 and the industries required to keep cost accounting records are given in appendix 24. *(section 209(1)(d) of the Companies Act 1956; Gupta K., 1992, Chapter 11)*

Details of what was meant by cost accounting records were not specified in the Companies Act 1956. The Government was delegated the task of identifying which industries would be required to keep cost accounting records and what was meant by cost accounting records. Since 1960, the central Government has prescribed rules regarding the maintenance of cost accounts. In practice, the Government has given this role to the ICWAI. The ICWAI have been delegated the task to prepare industry specific guidance as to what is meant by cost accounting records. This guidance is published by the Government and becomes binding on the industries which are required to keep cost accounting records. Thus the Government who, after consultation with the ICWAI, published details of what was meant by "cost accounting records". *(interviews with senior member of the accounting profession on 17th November 1998; interview with senior Indian academic on 7th November 1998; interviews with senior Government officials on 10th November 1998 and 17th November 1998)*

Cost auditing

In addition to the requirement for certain companies to maintain cost accounting records, the Government also introduced the cost audit requirement in 1965. Under Section 233(b) of the Companies Act 1956,the central government was given the power to order audits of the cost records kept by companies under section 209(1)(d) of the Companies Act 1956. These cost audits were to be carried out by cost accountants as defined by The Cost and Works Accountants Act 1959. The powers and duties of the cost auditor were similar to that of the statutory auditor, except that the cost auditor would not submit his audit report to

the shareholders. Instead, the cost audit report was submitted to the Government and to the company. The company had to furnish explanations for all qualifications contained in the cost audit report to the central government. The central government could seek clarification on the cost audit report from the cost auditor and could call for further information and explanations from the company. The central government could also direct the company to circulate the cost audit report to its members. Cost audits were not required annually, but had to be performed whenever directed by the Government. In practise, cost audits have been performed by members of the ICWAI, once every two years. The main cost audit rules are given in appendix 25. *(section 233(b) of the Companies Act 1956; interviews with senior member of the accounting profession on 17th November 1998; interview with senior Indian academic on 7th November 1998; Gupta K., 1992, Chapter 11; Kapadia G.P., 1972, Chapter 6; Haribhakti V.B., Chartered Accountant, vol xiv, September 1965, page 131 to 138)*

The ICAI was particularly concerned about the cost audit being undertake by members of the ICWAI. They argued strongly, both in the parliamentary process used to promulgate the cost audit regulations and in meetings with the Government directly, that they had the expertise to undertake cost audits. The ICWAI, however, argued that their members had the expertise in cost accounting and hence cost auditing should be undertaken by cost accountants. The Government agreed with the ICWAI and the regulations in the Companies (Amendment) Act 1965, stipulated that the cost audit would be performed by members of the ICWAI. *(interview with senior Indian academic on 7th November 1998; Gupta K., 1992, Chapter 11; Kapadia G.P., 1972, Chapter 6)*

The ICAI continued to actively lobby Government and Parliament to be allowed to undertake cost audits. In response to this, chartered accountants were given the right to undertake cost audits for a limited period of time. After this time, which was initially specified as ten years, only cost accountants would be allowed to perform cost audits. This relaxation of the Companies Act requirements was perhaps allowed due to the shortage of cost accountants in India in the 1960's. *(Kapadia G.P., 1972, Chapter 6)*

The ICAI was not happy with this relaxation, arguing that the Government was giving unfair protection to the ICWAI by giving cost accountants the task of performing cost audits. However, the ICAI also recognised that it was unlikely that the Government would change its mind and allow chartered accountants to undertake cost audits in the long term. The Government had made it clear that they perceived it to be more appropriate that cost auditing should be undertaken by members of the ICWAI rather than members of the ICAI. The ICAI had to accept the relaxation as the most favourable outcome that could be expected in the circumstances. *(Kapadia G.P., 1972, Chapter 6)*

From the above, it can be seen that interactions and negotiations between the ICAI and the ICWAI were very important in the reaction phase. The interactions took place both directly between the institutes and through the Government. The issue of mutual recognition was resolved through the setting up of a negotiating committee consisting of senior representatives from the ICAI and the ICWAI. Both the ICAI and the ICWAI were interested in the cost accounting and the cost auditing requirements and both institutes tried to influence these regulations in their own interests. The ICWAI proved to be the more successful, with the help of the Government.

Interactions between the Government and cost accounting

The Government was very much involved in the reaction phase to the setting up of the ICWAI, in all three main developments in this phase.

The Government was involved in the issue of mutual recognition between the ICAI and the ICWAI. They acted as a mediator between the two institutes and forced the two institutes to discuss the matter. In the diffusion phase, the ICAI had approached the ICWAI to argue that three categories of chartered accountants should be allowed automatically to become members of the ICWAI and be allowed to perform cost accounting work. In the reaction phase, the ICAI continued to lobby the Government for the same three categories of chartered accountants to be allowed to undertake cost accounting work. This was not accepted by the ICWAI who lobbied the Government against the right of

chartered accountants to automatically become members of the ICWAI. The Government did not make any decision on this issue and instead, suggested that the two institutes set up a joint negotiating committee to resolve the issue. *(Kapadia G.P., 1972, Chapter 6)*

When the negotiating committee was not able to reach a decision, they put forward proposals on the issue to the Government and the Government was asked to make the final decision. Thus, the Government made the final decision on the issue of mutual recognition. After agreement was reached, the Government stopped the ICAI from reopening negotiations on this issue when the ICAI wanted to reopen negotiations. Thus the Government significantly influenced the issue of mutual recognition. *(Kapadia G.P., 1972, Chapter 6)*

The Government was also important in the promulgation of the requirements for companies to maintain cost accounting records and the cost audit requirements. These regulations were initiated by the Government due to their perception that cost accounting and cost auditing was important for the development of the economy. The Government also steered the regulations through the parliamentary system and hence was important in influencing these regulations. *(Kapadia G.P., 1972, Chapter 6; Iyer R.S.V., Chartered Accountant, vol iii, October 1954, pages 169 to 173; Chopra S.P., Chartered Accountant, vol vii, May 1959, pages 317 to 320; Bhushan B.S.N., Chartered Accountant, vol vii, May 1959, pages 327 to 329; Haldia D.D., Chartered Accountant, vol ix, February 1961, pages 321 to 324; Dalal R.R., Chartered Accountant, vol xxi,, September 1972, pages 161 to 165)*

When the ICAI was unhappy with the cost audit requirements, they lobbied the Government to allow chartered accountants to undertake cost audits. The ICWAI also lobbied the Government to retain the cost audit for members of the ICWAI. The Government met with both the ICAI and the ICWAI, listened to both points of view and decided to put forward a compromise position. This was to allow chartered accountant with relevant experience to perform cost audits for a specified period of time, after which only cost accountants would be allowed to undertake cost audits. This may have also been influenced by the fact that there was a shortage of cost accountants in India at this time. *(Kapadia G.P., 1972, Chapter 6)*

From the above, it can be seen that the Government significantly influenced the ICWAI and the cost accounting and cost auditing provisions in the reaction phase to the change and were probably the most influential party in this change.

Trans-system activity

Interactions between Parliament and cost accounting

The parliamentary system was used to promulgate changes to the accounting system that related to cost accounting records and the cost audit. Both were included in amendment bills to the Companies Act 1956 and thus Parliament had the opportunity to influence the requirements for companies to keep cost accounting records and the cost audit requirements.

All parties interested in cost accounting presented their views within the parliamentary process. This included the ICAI, the ICWAI and the corporate sector. The ICWAI supported the provisions since the cost accounting and cost audit provisions were in their interests. The ICAI and the corporate sector were against the provisions and lobbied actively against them. The ICAI did manage to introduce some concessions at the select committee stage of the promulgation of the cost audit requirements. This was to allow chartered accountants to perform cost audits for ten years, until enough cost accountants had been trained to perform these audits. However, this was the only change that the ICAI was able to introduce. The regulations on cost accounting records and the cost audit, were proposed by the Government and supported by the ICWAI and were promulgated with little change during the parliamentary process. *(Aiyar S.A., February 1966, pages 448 to 453; interviews with senior member of the accounting profession on 17th November 1998; interview with senior Indian academic on 7th November 1998)*

Interactions between the corporate sector and cost accounting

The corporate sector was generally against any increase in the regulations that they had to follow and hence were against both the requirements to keep cost accounting records and the cost audit requirement. However, at this time, the Government was the most influential party and supported the cost accounting and auditing provisions. They argued that these were needed to help economic efficiency and economic growth. This was generally accepted and thus, the corporate sector was not successful in arguing against these requirements. *(Aiyar S.A., February 1966, pages 448 to 453; interviews with senior member of the accounting profession on 17th November 1998; interview with senior Indian academic on 7th November 1998)*

Culture and social context

Culture and social context are seen to be important in the setting up of the ICWAI and the promulgation of the regulations on cost accounting and cost audit in the reaction phase to the change.

From the cultural characteristics of India, it is expected that there will be an active and important accounting profession in India. The setting up of the ICWAI can be seen as part of the development of the strong accounting profession in India, in line and consistent with, the culture of India.

The primary reason for the Government actively setting up the ICWAI as a statutory body was the perception that cost accounting was an important tool for economic development, particularly in the public sector which the Government was actively setting up. Thus, the economic and political context of India influenced the setting up of the ICWAI. Indeed, the social ideals present in India at independence were seen to be promoted by cost accounting which would help substantiate or refute claims by the corporate sector that rewards to labour in the form of higher wages was not possible due to low productivity and high costs. Representatives of employees argued that the corporate sector was able to avoid

paying labour a fair wage due to arguments about cost, which could not be checked without cost accounting. Thus cost accounting was necessary, not only to improve cost consciousness and efficiency in the economy but also to help ensure fairness in the rewards earned by capital, labour and management.

In the diffusion phase, the Government decided to set up a statutory institute to run the cost accounting profession, using legislation promulgated through the parliamentary system. This fits in with the culture of India in many ways. The use of statutory legislation to change the accounting system in India is common, most of the regulations affecting the accounting system are promulgated using the parliamentary system and there is strong Government involvement in accounting in India. This is expected in a country with the cultural values of India.

Culture and social context are also seen to be important in the reaction phase. Again, there is Government involvement in accounting together with an active accounting profession. Thus both government control as well as professional control of accounting is seen to be important in India. Issues such as mutual recognition are raised by the Government and the outcome of these issues are determined, mainly by the interactions between the Government, the ICAI and the ICWAI.

Cost accounting and cost auditing were introduced into the Companies Act 1956, using amendment bills to the Companies Act, which were promulgated through the parliamentary system. Thus the Government and the parliamentary system were also seen to be important in the reaction phase to the change. In addition, the main reasons for promulgating the cost accounting and the cost auditing regulations related to the economy and the need to improve economic growth. Both the keeping of cost accounting records and the cost audit requirements were seen as important for helping to improve economic performance, especially in the public sector where there were no competitive pressures.

Thus, from the above, it can be seen that the cultural and social context was important in influencing accounting change in India and was seen to influence all phases of the change.

Politics and accounting change

The setting up of the ICWAI and the reaction to the setting up of the ICWAI is seen to be very political. As in most of the accounting changes analysed, the setting up of the ICWAI is political in that there is Government involvement in accounting change and that change is promulgated using statutory legislation promulgated through the parliamentary system.

In addition, the setting up of the ICWAI and the reaction to the setting up of the ICWAI was surrounded by political processes and interactions between the different parties interested in cost accounting. The main interactions were between the Government, the ICAI, the ICWAI and the corporate sector. The ICAI was the most active party in the setting up of the ICWAI since they perceived the greatest threat to their autonomy, status and power. The ICAI was very much against the setting up of the ICWAI and tried to argue against this. Once it became clear that the Government would set up the ICWAI as an independent professional institute, the ICAI tried to limit the role of the ICWAI and tried to ensure that chartered accountants could continue to undertake cost accounting work. The ICAI did have some limited success, at least in the short term but, on the whole, the ICAI was not successful in stopping the stetting up of the ICWAI. This may have been due, in part, to the perception by the Government that the ICAI was too influential and that there was a need for another accounting institute to limit the influence of the ICAI.

The ICWAI were less active in the setting up of their institute as a statutory body but were, perhaps, more influential in the change than the ICAI. The ICWAI were less active since the Government recognised the need for cost accounting

and that cost accounting should be regulated by a separate institute from the ICAI. The Government therefore acted in the interests of the ICWAI and hence all the ICWAI was required to do was support the Government. Thus the Government, who promoted the setting up of the ICWAI as a statutory body, and the privately run ICWAI who supported the Government, were the most influential party in the change.

Conclusion

The setting up of the ICWAI can be broken down into source, diffusion and reaction phases, using the theoretical framework proposed in chapter 3.

The change is initiated, in the source phase, due to concerns for economic development and the perception in Government that cost accounting was an important tool to help in this. The reasons for initiating the change were linked to industrial policy and improved efficiency in the public sector.

Both intra-system activity and trans-system activity took place in the diffusion phase and the reaction phase of the change. However, intra-system activity was more significant than trans-system activity in both the diffusion and the reaction phase. In particular, the change was influenced by the interactions between the ICAI, the ICWAI and the Ministry of Commerce. In the diffusion phase, the ICWAI was set up as a statutory body. This was supported by the Ministry of Commerce and the privately run ICAWI and was opposed, unsuccessfully, by the ICAI.

There were three main events in the reaction phase, the issue of mutual recognition, the requirement for certain companies to keep cost accounting records and the requirement for certain companies to have cost audits. The issue of mutual recognition was negotiated by the ICAI and the ICWAI with the Government playing an important mediation role between the two institutes. The

cost accounting and cost auditing regulations were supported by the Ministry of Commerce and the ICWAI and opposed by the ICAI. In all three developments the ICAI tried to restrict the role of the ICWAI and tried to increase its own role and influence over cost accounting. The ICAI had only very limited success in changing the regulations and the Government and the ICWAI were the most influential parties in the setting up of the ICWAI and in the promulgation of the cost accounting and cost auditing regulations.

Culture and social context affected all three phases of the change. In the source phase, the need for cost accounting came from the economic and political context of the country i.e. the need for economic development alongside social justice and equality. In the diffusion phase, the setting up of the ICWAI and the use of the parliamentary system to promulgate regulations was consistent with the culture of India, in which statutory control and professional control are expected to be important. This was also seen in the reaction phase with both strong Government involvement and with strong interactions between the accounting profession, both the ICAI and the ICWAI, in the process of promulgating cost accounting regulations.

The whole process of accounting change was also seen to be political with strong Government involvement in accounting, regulations affecting the accounting system being incorporated into statutory legislation, which was promulgated through the parliamentary system, and the outcome of accounting regulations being the result of interactions, mainly between the Government, the ICAI and the ICWAI.

Thus it can be seen that the theoretical framework proposed in chapter 3, is helpful in analysing accounting change. Accounting change can be analysed into three clear phases and the framework does help in analysing interactions between the main parties involved in the change. In addition the analysis of culture and politics on accounting change is also facilitated by the theoretical framework.

Chapter 13

The Influence of Taxation on Accounting

Introduction

Taxation, whether explicitly or implicitly, is an important influence on financial reporting in most countries. The collection of taxation is based on financial accounts whether taxable profits are obtained directly from financial reports, as in Germany, or whether the financial accounts are used as a starting point for the calculation of taxable profits, as in the United Kingdom.

In India, in common with the United Kingdom, financial accounts are used as the starting point for the calculation of taxes. Adjustments are made to accounting profits in accordance with the Income tax Act 1961, to arrive at taxable profits. Until recently, the accounting polices used by companies in their annual accounts have been left to the discretion of the companies, subject to regulations in the Companies Act 1956 and regulation by the accounting profession.

The Ministry of Finance is responsible for the administration and finances of the central government. It manages the economy and finances of the country, regulates and monitors the expenditure of Government and is responsible for the collection of revenue. Corporation tax is administered by the Central Board of Direct Taxes (CBDT) which is under the Department of Revenue within the Ministry of Finance. The Ministry of Finance is headed by the Minister of Finance, a senior cabinet post, and the administrative head of the Ministry is the Finance Secretary who is usually, though not always, a member of the Indian Civil Service. The main tax regulations are incorporated into the Income Tax Act 1961 and in rules prepared by the tax authorities, under powers given to them, under the Income Tax Act 1961. *(Chapter 4; Kotrappa G., 1996, chapter 1; Interview with senior government official on 16th November 1998; Arora R.k. and Goyal R., 1996, pages 177 to 183)*

In India, as in most other countries, taxation and the tax authorities have been an important influence on the accounting system. The two most important changes to the accounting system that have taken place in India due to the influence of tax on the accounting system are the regulations on tax audits and the regulations on tax accounting standards. Both these changes are discussed below.

The Taxation audit

The regulations on the tax audit were promulgated in 1984 and companies were required to have tax audits undertaken for the 1985/1986 tax year and subsequent years. The tax audit regulation was initiated by the Finance Minster in his budget speech in 1984 and the regulations requiring tax audits were included in the Finance Bill 1984, which was promulgated through the parliamentary system. This included:

- introduction of the Finance Bill in Parliament by the Finance Minister.
- a three month review period to receive feedback on the provisions of the Finance Bill
- parliamentary debates on the Finance Bill in both Houses of Parliament

(Kotrappa G., 1996, Chapter 1; Interview with senior government official on 16th November 1998; Gupta K., 1992, Chapter 15)

The Finance Bill 1984 amended Section 44 of the Income Tax Act 1961 to include the tax audit provisions. Under this section all businesses, including companies and professions, were required to have a tax audit performed if their income was over a specified amount. The tax audit had to be carried out by an independent accountant and general opinion was that the tax audit had to be carried out by a chartered accountant.

The tax auditor had to prepare a tax audit report in a format prescribed by the Income Tax Act 1961. This report had to state whether the financial statements showed a true and fair view, were true and correct and included disclosures as specified in the Income Tax Act 1961, for example any tax charged in the accounts but not paid. Tax auditors did not need to repeat the true and fair audit for businesses who were required to have audits under other regulations. For example, companies were already required to have audits under the Companies Act 1956 and hence the tax audit in companies did not need to repeat the true and fair audit. However, non- corporate assessees such as professionals and members of stock exchanges were required to have tax audits which included an audit on whether their accounts gave a true and fair view. The main tax audit provisions are summarised in appendix 26. *(Sections 44AB of the Income Tax Act 1961; Income Tax rules, 1962; Kotrappa G., 1996, Chapter 1; Interview with senior government official on 16th November 1998; Gupta K., 1992, Chapter 15; Ranaka N.M., Chartered Accountant, Vol xxxiv, July 1985, pages 35 to 36)*

It has been generally accepted that, for effective tax audits, tax auditors should develop an approach which is a synthesis of taxation laws and auditing principles and should follow generally accepted auditing guidelines, which are issued by the ICAI. In addition, until recently, the Income Tax Act 1961 and the Income Tax rules framed under the Act did not prescribe any form in which the balance sheet and the profit and loss account were to be prepared. However, for companies, the financial statements had to be prepared in accordance with the regulations of the Companies Act 1956 and accounting standards issued by the ICAI, and it was expected that non-corporate tax assessees too would follow accounting regulations prescribed by the ICAI. *(Sections 44AB and 288(2) of the Income Tax Act 1961; Interview with senior government official on 16th November 1998; Gupta K., 1992, Chapter 15; Shah P.N., Chartered Accountant, Vol xxxii, May 1984, pages 707 –708; Editorial, Chartered Accountant, Vol xxxii, April 1984, pages 631 to 632)*

The promulgation of the regulation for companies to have tax audits, using the theoretical framework proposed in chapter 3, is discussed below:

Analysis of the promulgation of the tax audit regulations

The promulgation of the regulation for companies to have tax audits, using the theoretical framework outlined in chapter 3, can be broken down into source, diffusion and reaction phases as follows:

The Source Phase

The source of the tax audit regulations can be traced to the aims of the tax system and the problems that were present in the taxation system in India in the 1980's. The primary aim of the tax system was to maximise the collection of taxation revenue. In addition to this, other important aims of the tax system were to help to control the concentration of economic wealth, mitigate the adverse impact of high taxation on corporate savings and investment and encourage the achievement of socio-economic objectives.

The many aims of the taxation system have led to a very complex tax system in India which has had limited success in achieving its stated aims. India has traditionally had very high tax rates, for both personal tax and corporate tax. In the 1980's, India was argued to be one of the highest taxed nations in the world, despite reductions seen in the tax rates in the 1980's, with corporate tax rates still over 50%. This led to low tax collection with tax avoidance, evasion, fraud and corruption being widespread in the economy.

In addition, the tax base was very narrow with only relatively few companies, the larger companies, paying tax. In the tax year 1983-1984, 65% of all tax assessments raised came from companies with income of less than 1 lakh rupees but these yielded less than 1% of tax revenue. Companies with income over 5 lakh rupees, on the other hand, comprised less than 18% of the tax assessments raised, but contributed over 96% of the tax revenue.*(Interview with senior government official on 16th November 1998; Kotrappa G., 1996, Chapter 1; Mundle and Rao, 1992, pages 235 to 239)*

This was possibly due to the following :

- large companies play an important role in the Indian economy. The corporate sector consists of a few large companies and a large number of small and medium sized companies which are, usually, family owned and managed. The large companies are successful and contribute to the tax revenue. The other companies have not contributed to the tax revenue due to their poor performance. This has been exacerbated by the economic policies implemented by the Indian Government, with Indian companies being protected from competition leading to inefficiencies and losses in a large part of the corporate sector.

- tax avoidance, evasion and corruption has been common amongst all but the largest companies, partly in response to the high corporate tax rates set by the Government.

(Interview with senior government official on 16th November 1998; Kotrappa G., 1996, Chapter 1; Mundle and Rao, 1992, pages 235 to 239)

The regulations for companies to have tax audits was initiated to deal with some of the problems in the tax system outlined above. These included

- the need to increase the tax yield .
- the need to make tax collection speedier and more efficient.
- the need to relieve the tax authorities from routine checking of tax forms and leave them time for tax investigations
- the need to reduce tax evasion, avoidance, and corruption.

(Interview with senior government official on 16th November 1998; Kotrappa G., 1996, Chapter; Editorial, Chartered Accountant, Vol xxxii, April 1984, pages 631 to 632; Shah P.N., Chartered Accountant, Vol xxxii, May 1984, pages 707 -708)

Thus it can be seen, once again, that the changes to the accounting system, were implemented for reasons that came from outside the accounting system. In the promulgation of the regulations on tax audits, these related to economic concerns and problems in the tax system such as low tax yields, inefficient tax collection and tax evasion.

The Diffusion Phase

The tax audit regulations were promulgated to deal with problems in the economy in the collection of taxes, as outlined above. Auditing had been inherited from the British at independence and was retained by India after independence since auditing was seen as an important tool for social and economic development. Indeed, auditing was used extensively in India with many different audits introduced in India after independence. These included the statutory audit, the social audit under the Manufacturing and Other Companies Auditing Regulations Order (MAOCARO), the cost audit and the special audit. *(Chapter 5)*

In the 1980's, the tax audit was added to the other audits required in India. The tax audit regulations were promulgated by the Government using the annual budget process as follows:

- the Finance Minister announced his intention of promulgating the regulations in his budget speech
- the regulations were included in the Finance Bill 1984, which was promulgated through the parliamentary process. This included introduction into Parliament by the Finance Minister, a three month feedback period and parliamentary debates on the Bill. The Finance Bill 1984 amended the Income tax Act 1961 to introduce the tax audit provisions into Section 44 of the Income Tax Act 1961.

  (Interview with senior government official on 16th November 1998; Gupta K., 1992, Chapter 15; Sections 44AB and 288(2) of the Income Tax Act 1961; Editorial, Chartered Accountant, Vol xxxii, April 1984, pages 631 to 632; Shah P.N., Chartered Accountant, Vol xxxii, May 1984, pages 707 -708)

Both intra-system activity and trans-system activity are seen in the diffusion phase of the promulgation of the regulations on the tax audit. Intra-system activity (activity between the regulatory institutions within the accounting system) is seen mainly between the DCA and the accounting profession, in particular the ICAI, and the tax audit regulations. Trans-system activity (activity between social systems neighboring the accounting system and the accounting system) is seen between the parliamentary system, the corporate system and the tax system and the tax audit regulations. Both intra-system activity and trans-system are discussed below.

Intra-system activity

Interactions between the DCA and the tax audit

The DCA were not responsible for the promulgation of the tax audit regulations and hence were not significantly involved in the promulgation of the these regulations. However, it is likely that informal interactions would have taken place between the DCA and the CBDT, who were responsible for the promulgation of the tax audit regulations. The DCA would have been consulted about the tax audit regulations since these affected both the corporate sector and the accounting profession who were regulated by the DCA. This consultation would have taken place between the DCA and the CBDT informally, both before and after the budget presented by the Finance Minister. *(Interviews with senior Government officials on 16th November 1998)*

Government departments generally co-operate unless there is an issue which creates conflicts of interest or shifts of power between departments. This was not the case in this change. The tax audit was an extra audit which would be required by statutory legislation and did not affect the interests of the DCA. The DCA were therefore involved in the promulgation of the tax audit regulations but less so than in the promulgation of other legislation for example the Companies Act 1956 and the regulations on the Chartered Accountant Act 1949.

Interactions between the accounting profession and the tax audit

The Institute of Chartered Accountants of India (ICAI) and the tax audit

The ICAI was very involved in the promulgation of the tax audit regulations in several ways. Each year the ICAI send in pre budget and post budget memorandum to the Government and the Ministry of Finance, giving their views on what issues need to be addressed and the ICAI's view on these issues. In addition, meetings are held between the ICAI and the CBDT and other tax authorities whenever there are tax issues which affect the ICAI. The CBDT is also represented on the Council of the ICAI. Hence, there is plenty of opportunity for exchange of views between the two institutions and plenty of

opportunity for the ICAI to argue against any provisions they are unhappy with or support the provisions which they are happy with, directly with the CBDT and other tax authorities. *(Interviews with senior Government officials on 10th November 1998, 17th November 1998 and 16th November 1998; Interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998; Vishwanath T.S., Chartered Accountant, vol xlv, October 1996, pages 3 to 4; Balakrishnan R., Chartered Accountant, vol xxxv, February 1987, pages 619-620)*

With respect to the tax audit regulations, the ICAI submitted detailed pre and post budget memoranda to the Finance Minister welcoming the tax audit provisions and refuting the criticisms of the provisions which were being made by the corporate sector. These criticisms included:

- that small traders would have to face increased costs since they would have to keep elaborate books of account and records.
- that there might be a shortage of chartered accountants to undertake the tax audits which would increase costs for companies and add delays to the audit and tax collection process.
- that the time limit for the tax audit to be completed was too short and hence the tax audits would not be able to be completed within the time periods specified.

(Editorial, Chartered Accountant, Vol xxxii, April 1984, pages 631 to 632; Shah P.N., Chartered Accountant, Vol xxxii, May 1984, pages 707 -708)

The ICAI gave assurances to the Government on the above criticisms. They argued

- that the tax audit regulations would not apply to small traders. The turnover levels at which the regulation for the tax audit had been set meant that only companies who already had to keep accounting records in detail would need tax audits.
- there would not be a shortage of chartered accountants and that the time limits were adequate for completion of the tax audit. Indeed the members of the ICAI would work closely with their clients to ensure that tax audits were completed on time.
- the ICAI would impose regulations on their members so that no one auditor could undertake more than a certain number of audits, similar to the restriction on the number of audits placed on the statutory audit and the cost audit. This would ensure that the tax audit work was spread out over the whole accounting profession and not restricted to just the large

auditing firms. The provisions would also help to restrict the tax audit fees such that the tax audit would not be too costly.

These arguments were also made in meetings which were held between the CBDT and the ICAI before and after the budget to discuss promulgation of the tax audit and were also made in the press and the Institutes journal, the Chartered Accountant. *(Editorial, Chartered Accountant, Vol xxxii, April 1984, pages 631 to 632; Shah P.N., Chartered Accountant, Vol xxxii, May 1984, pages 707 –708; Vishwanath T.S., Chartered Accountant, vol xlv, October 1996, pages 3 to 4; Balakrishnan R., Chartered Accountant, vol xxxv, February 1987, pages 619-620; Interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998)*

The ICAI were, on the whole, happy with the tax audit regulations. It had been made clear by the CBDT that the tax audits would be carried out by members of the ICAI and indeed, that statutory auditors would be able to undertake the tax audits alongside the statutory audit. In addition, the tax audit would apply to more than the larger companies of the corporate sector. The tax audit provisions would also apply to members of professions who earned above a specified level of income and to all active members of stock exchanges. These non-corporate audits would also be undertaken by the members of the ICAI and it was expected that the accounts of the members of the profession and the stock exchange members would also comply with the accounting standards issued by the ICAI.

The tax audit regulations, therefore, increased the work available for chartered accountants and for the auditing profession and also gave them extra power and status. The ICAI, therefore, not unsurprisingly, supported the tax audit provisions in their pre and post budget memoranda, in meetings with the tax authorities and in the parliamentary process. *(Interview with senior academic on 7th November 1998; Interviews with senior Government officials on 10th November 1998, 17th November 1998 and 16th November 1998; Interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998; Interviews with senior accounting personnel in companies on 27th October 1998, 29th October 1998, 2nd November 1998 and 5th November 1998)*

The other accounting professional bodies, the ICWAI and the ICSI not involved in the change since the tax audit did not affect these institutions.

Trans – system activity

Interactions between the Government and the tax authorities and the tax audit

The Government of India, in particular the Finance Minister, and the CBDT were very important in the promulgation of the tax audit regulations.

In general, each year the Finance Minister outlines the economic and fiscal policies that the Government will be implementing, including changes to the tax system, in the annual Finance Bill. This is followed by a three month feedback period on the Finance Bill and parliamentary debates on the Finance Bill in both Houses of Parliament. Before the budget speech, the Finance Minister and the Ministry of Finance work closely together to consider the options available, decide what will be included in the budget speech and the Finance Bill and to draft the budget speech and the Finance Bill. After the budget speech, the Finance Minister introduces the Finance Bill into Parliament and, together with the Ministry of Finance, steers it through the parliamentary system. The Ministry of Finance and the tax authorities within the Ministry, work closely with the Finance Minister throughout the process for promulgating the Finance Bill. This includes consulting with the main interested parties throughout this promulgation process. *(Interviews with senior Government officials on 16th November 1998; Editorial, Chartered Accountant, Vol xxxii, April 1984, pages 631 to 632; Shah P.N., Chartered Accountant, Vol xxxii, May 1984, pages 707 –708)*

The tax audit provisions were introduced in the Finance Minister's budget speech on 29th February 1984 and incorporated into the Finance Bill 1984. The Finance Bill 1984 was promulgated using the parliamentary process, described above, for promulgating finance bills each year. The tax audit provisions went through the parliamentary system with little change and were therefore promulgated in line with the Governments wishes. Thus, the Government and the CBDT, in Ministry

of Finance, decided on the importance of the tax audit provisions, included them in the budget speech and finance bill and steered the provisions through Parliament. The tax audit provisions were administered by the CBDT, who were instrumental in the promulgation of the provisions since they advised the Government on problems and solutions to raising tax. (*Editorial, Chartered Accountant, Vol xxxii, April 1984, pages 631 to 632; Shah .N., Chartered Accountant, Vol xxxii, May 1984, pages 707 –708; Gupta K., 1992, Chapter 15)*

Interactions between the Parliamentary system and the tax audit

Parliament had the opportunity to influence the tax audit regulations since they were included in the Finance Bill 1984 which was promulgated through the parliamentary process. This included introduction in Parliament on 29th February 1984 by the Government, a three month feedback period followed by parliamentary debates on the Bill, in both Houses of Parliament. The Finance Bill introduced the tax audit regulation into section 44 of the Income Tax Act 1961.

Parliament supported the tax audit regulations. Most members of parliament accepted that tax revenue needed to be increased and that collection of taxes needed to be made speedier and more efficient. It was perceived that the tax audit regulations would help in this. Therefore, despite arguments made by the corporate sector as outlined below, Parliament did not amend the tax audit regulations and they were promulgated in 1984, in line with the wishes of the Government and the tax authorities. *(Editorial, Chartered Accountant, Vol xxxii, April 1984, pages 631 to 632; Shah P.N., Chartered Accountant, Vol xxxii, May 1984, pages 707 – 708; interview with senior Government official on 16th November 1998)*

Interactions between the corporate sector and the tax audit

The corporate sector was very much affected by the tax audit provisions. They were, generally not in favour of the tax audit provisions since the provisions added an extra audit which needed to be performed. The tax audit regulations thus added costs to the companies, costs which generally benefited the

Government in the administration of tax collection, but provided little benefit to the companies themselves. *(Interviews with senior accounting personnel in companies on 27th October 1998, 29th October 1998, 2nd November 1998 and 5th November 1998)*

The corporate sector interacted with the tax authorities and the Government to try and persuade them to drop the tax audit regulations. They made representations within the parliamentary process, by sending representations to the Government and the tax authorities in the three month feedback period and lobbying members of parliament to present their arguments. Some of this lobbying was done by individual companies but most of the lobbying was done through chambers of commerce and trade associations. It is expected that the corporate sector would also have made their point of view outside the parliamentary system. This would have been done in meetings with the CBDT and other tax authorities and members of the Government and in the general press. These arguments included that:

- small traders would have increased costs since they would have to keep elaborate books of account and records.
- there might be a shortage of chartered accountants to undertake the tax audits which would increase costs for companies and add delays to the audit and tax collection process.
- that the time limit for the tax audit to be completed was too short and the audits could not be completed in the time periods set.

  (Interviews with senior accounting personnel in companies on 27th October 1998, 29th October 1998, 2nd November 1998 and 5th November 1998; Interview with senior Government official on 16th November 1998; Editorial, Chartered Accountant, Vol xxxii, April 1984, pages 631 to 632; Shah P.N., Chartered Accountant, Vol xxxii, May 1984, pages 707 –708)

However, the Government considered the tax audit provisions to be important and were given assurances from the ICAI that small traders would not face elaborate accounting regulations and that there would be enough chartered accountants to perform the tax audits, within specified time limits and without charging unreasonably high fees. Hence, the corporate sector had little influence and were unable to have the tax audit regulations removed. The corporate sector did manage to have some concessions made to the tax audit regulations. It was confirmed that the tax audit would initially apply only to large companies,

companies with turnover of more than 40 lakh rupees, and not to the rest of the corporate sector. Initially the tax audit provisions were drafted to apply to all companies with a turnover of more than 20 lakh rupees. This gave some relief to the small and medium sized companies for whom the costs of the tax audit would have been very onerous. *Interviews with senior accounting personnel in companies on 27th October 1998, 29th October 1998, 2nd November 1998 and 5th November 1998; Interview with senior Government official on 16th November 1998; Editorial, Chartered Accountant, Vol xxxii, April 1984, pages 631 to 632; Shah P.N., Chartered Accountant, Vol xxxii, May 1984, pages 707 –708)*

From the above, it can be seen that the corporate sector were generally against the tax audit provisions and lobbied the Government and Parliament against these provisions. However, the corporate sector were not able to influence the provisions since the Government and the tax authorities considered the provisions to be very important for increasing the collection of taxes and to improve the efficiency with which with which tax was collected.

The Reaction Phase

As discussed in chapters 6 to 12, the system of promulgating regulations in India is such that interested parties try and influence statutory regulation, before they are promulgated. Once the regulations are promulgated and become law, companies follow the regulations in a very uniform manner. Instead, lobbying takes place to try and change the regulations if they are thought to be too onerous or ineffective. This is very much in line with the culture of India and is again seen in the promulgation of the tax audit regulations.

Despite their stance against the tax audits regulations, the companies who fulfilled the income criteria to need a tax audit, complied with the regulations and did have tax audits carried out. Although not visible and therefore hard to analyse, it is expected that the corporate sector would have been active in the reaction phase since they were the party most affected by, and unhappy with, the

regulations. They would have continued to make representations against the tax audit provisions after they were promulgated, mainly through the chambers of commerce and trade associations, who would have held meetings with the Government, the tax authorities and members of parliament to try and influence the regulations.

The corporate sector were not successful in removing the tax audit regulations since the tax audit provisions were generally accepted as being important for tax collection and were supported by the Government, the tax authorities and the accounting profession. Thus the most influential party in the reaction phase would have been the Government and the tax authorities. The accounting profession would also have been involved in the reaction phase, but to a lesser extent and only to support the Government and the tax audit provisions. *(Rao B.P., Chartered Accountant, vol xliii, July 1994, pages 3 to 4; Agarwal K.M., Chartered Accountant, Vol xxxix, March 1991, pages 707 to 708; Dalal A.H., Chartered Accountant, Vol xxxviii, June 1990, pages 915-916; Interviews with senior Government officials on 10th November 1998, 16th November and 17th November 1998; interviews with senior accounting personnel in companies on 27th October 1998, 29th October 1998, 2nd November 1998 and 5th November 1998)*

After the tax audit regulations were promulgated, there was an improvement in amount of tax collected, in the efficiency of the collection of the taxes and in widening the tax base, in the 1980's. This led to initial optimism in the Government that the tax audit regulations would deal with some of the problems of the tax system and improve tax payment by the corporate sector.

In fact, the tax audit regulations did not prove too onerous in practice for the corporate. As outlined above, the tax audit was only required by large companies and despite their initial reluctance, the large companies did comply with the tax audit provisions. Indeed in interviews with members of the corporate sector, the companies stated that they were not reluctant to follow the tax audit regulations since efficient tax collection was important to them too.
There was also significant overlap between the statutory audit and the tax audit. For example, both audits required auditors to check whether the accounts gave a

true and fair view. Indeed, tax assesses, such as companies, who were already required to have a statutory audit under the Companies Act 1956, did not then again have to be audited by the tax auditor to check whether the accounts gave a true and fair view. In these cases, only a few extra checks were required for the tax audit. For example, checks on whether specified information was true and correct and disclosures of a few extra items. In addition, the tax audit could be carried out by the company's statutory auditors and at the same time as the statutory audit and hence was not, in practice, too much of an extra burden on the corporate sector. *(Interviews with senior Government officials on 10th November 1998, 16th November and 17th November 1998; Interviews with senior accounting personnel in companies on 27th October 1998, 29th October 1998, 2nd November 1998 and 5th November 1998; Chapter 5)*

In the 1990's, some members of the Government and some members of parliament considered that, despite its intention, the tax audit regulations had not been as successful as expected. This was due to the application of the tax audit regulations only to large companies in the corporate sector, who were being audited anyway, were generally paying their taxes and due to tax evasion and corruption being prevalent in the economy.

The accounting profession was also criticised for colluding with companies to evade tax. The Government held meetings with the ICAI and discussed this problem with them. The Government made it clear that they expected the chartered accountants and the auditing profession to refrain from colluding with the corporate sector in tax evasion scams. The Government stated that they might have to increase tax rates to increase tax revenues since decreasing tax rates had not increased tax revenues. The Government had decreased the corporate tax rates to below 40% but despite this, the tax revenue had not increased as expected, on the basis of evidence in other countries that showed that decreasing tax rates generally increased tax revenue. This was put down to large scale tax evasion in the corporate sector which could only be done with the collusion of the tax auditors who were chartered accountants and members of the ICAI. *(Rao B.P., Chartered Accountant, vol xliii, July 1994, pages 3 to 4; Agarwal K.M.,*

Chartered Accountant, Vol xxxix, March 1991, pages 707 to 708; Dalal A.H., Chartered Accountant, Vol xxxviii, June 1990, pages 915-916)

The corporate sector, in the 1990's, still continued to present arguments to try and restrict the applicability of the tax audit. They argued that the limits for deciding which companies were required to have tax audits, needed to be increased in line with inflation so that the tax audit regulations still applied just to the largest companies in the corporate sector. However, this was not accepted. The tax authorities considered that the limits should not be increased so that more companies qualified for tax audits. This would increase the number of companies being audited and would hopefully widen the tax base further and increase the tax revenue from the corporate sector. *(Interview with senior Government official on, 16th November 1998; Rao B.P., Chartered Accountant, vol xliii, July 1994, pages 3 to 4; Agarwal K.M., Chartered Accountant, Vol xxxix, March 1991, pages 707 to 708; Dalal A.H., Chartered Accountant, Vol xxxviii, June 1990, pages 915-916)*

The current position is that the tax audit is still required and the limits have not been increased, to increase the number of companies to which the tax audit applies. In addition, the regulations on tax accounting standards may, in part, have been initiated in response to disappointing tax collection, despite reductions in tax rates and the tax audit regulations. This was put down to collusion in tax evasion by the tax auditors who were mainly chartered accountants. This may have contributed to the need to control the accounting profession which was one of the reasons for promulgating the regulations on tax standards. The promulgation of the regulations on the accounting standards is discussed below.

Accounting standards promulgated by the taxation authorities

The next major change in the taxation system which affected the accounting system took place in 1995 with the promulgation of accounting standards by the CBDT. In presenting the 1995 budget, the Finance Minister proposed amendments to the provisions of the Income Tax Act 1961. Section 145 of the Income tax Act 1961 was amended, empowered the CBDT to specify accounting

standards that all tax assessees, including the corporate sector, would be required to follow for tax purposes, by notification in the official gazette. *(Section 145 of the Income tax Act 1961; Sikidar S., 1997, Chapter 8; Shah P.N., Chartered Accountant, Vol xlv, July 1996, pages 11 to 18; Pandey T.N., Chartered Accountant, Vol xliii, May 1995, pages 1459 to 146)*

On 25 January 1996, notification was given by the Central Board of Direct Taxes (CBDT) in the Department of Revenue, that the following accounting standards were to be followed by all assessees for the assessment year 1997-1998 and subsequent years:

- Tax accounting standard 1 relating to the disclosure of accounting policies. The main provisions of tax accounting standard 1 are summarised in appendix 13 (b).

- Tax accounting standard 2 relating to disclosure of prior period and extraordinary items and change in accounting policies. The main provisions of tax accounting standard 2 are summarised in appendix 13(c).

  (Accounting standards 1 and 2 issued under notification number 9949, Government of India, 1996)

Thus the provisions giving the CBDT the power to issue accounting standards were included in the Finance Bill 1995 which was promulgated through the parliamentary process. Once these powers were in place, the CBDT issued accounting standards by notification. The promulgation of accounting standards by the CBDT is discussed below:

Analysis of the promulgation of the tax accounting standards by the CBDT

The Source Phase

The source of the regulations on tax accounting standards can also be traced to the aims of the tax system in India. Before these regulations, companies were allowed to follow any accounting principles they wanted to subject to certain

minimum regulations in the Companies Act 1956. However, the Companies Act 1956 contained mainly disclosure regulations and did not regulate many measurement practices. This left the corporate sector with a great deal of freedom in choosing their accounting policies, which affected their accounting profits and hence their taxable profits. Accounting profits were the starting point for the calculation of taxable profits and adjustments were made to the accounting profits to arrive at taxable profits. These adjustments related mainly to capital allowance adjustments and timing differences on items such as interest payable and interest receivable. All other accounting policies were either chosen in accordance with accounting standards issued by the ICAI or left entirely to the discretion of the companies. Indeed, due to poor enforcement of accounting standards issued by the ICAI, companies were able to follow the accounting standards only if they wanted to, and were not penalised for not following the standards issued by the ICAI if they chose not to. In practice, the large companies did follow the accounting standards issued by the ICAI but not all the corporate sector did. *(Interview with senior government official on 16th November 1998; Kotrappa G., 1996, Chapter 1; Interviews with senior Government officials on 10th November 1998, 16th November and 17th November 1998; Interviews with senior accounting personnel in companies on 27th October 1998, 29th October 1998, 2nd November 1998 and 5th November 1998; Interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998; Chapter 11)*

The CBDT and the Ministry of Finance were concerned that the accounting policies and practices followed by the corporate sector was affecting the tax collected. Some of the accounting policies and practices were regulated by the ICAI through their accounting standards but not very effectively, in the opinion of the CBDT and the tax authorities, due to poor enforcement. The CBDT therefore wanted to issue accounting standards which would be enforceable on all companies and which would make financial reports more transparent for tax collection purposes. In addition, they felt that accounting, which was seen as a tool for economic and social development, was too important to be left in the hand of the ICAI whose primary aim was to look after the interests of their members, the chartered accountants and auditing firms and their clients, the

companies. *(Accounting standards 1 and 2 issued under notification number 9949, Government of India, 1996; Interview with senior Government official on 16th November 1998; Rao B.P., Chartered Accountant, vol xliii, July 1994, pages 3 to 4; Agarwal K.M., Chartered Accountant, Vol xxxix, March 1991, pages 707 to 708; Dalal A.H., Chartered Accountant, Vol xxxviii, June 1990, pages 915-916)*

These concerns led to the promulgation, by the CBDT, of tax accounting standards in their own right. There was the general perception in the CBDT and other government departments that tax revenue was being adversely affected by the accounting policies and practices followed by companies, particularly in the area of measurement. The measurement practices were mainly regulated by the accounting profession or not at all. This led to power in the hands of the ICAI and the auditing firms and too much flexibility for the corporate sector in accounting matters which was not deemed desirable by the Government in general, and the CBDT in the Ministry of Finance in particular. In addition, tax revenues had not increased, despite decreases in the corporate tax rates and despite the introduction of the tax audit in the 1980's. The Government considered that this may, in part, have been due to collusion between the corporate sector and the tax auditors in tax evasion scams, and this needed to be controlled. Thus the Government and the CBDT initiated the promulgation of the tax accounting standards. *(Interview with senior Government official on 16th November 1998; Rao B.P., Chartered Accountant, vol xliii, July 1994, pages 3 to 4; Agarwal K.M., Chartered Accountant, Vol xxxix, March 1991, pages 707 to 708; Dalal A.H., Chartered Accountant, Vol xxxviii, June 1990, pages 915-916)*

From the above it can be seen that changes to the accounting system arise from outside the accounting system. There is no one change stimulating event. Instead, once again, the Government's concerns for economic and social development lead to changes to the accounting system being initiated.

The Diffusion Phase

The diffusion phase of the promulgation of the regulations on tax accounting standards comprised of two stages. The first stage was the promulgation of

regulations giving the CBDT the power to issue accounting standards in their own right. This was done in 1995 by the Finance Minister introducing the regulations is his budget speech, and in the Finance Bill 1995, which was promulgated through the parliamentary system. This system was identical to the process for promulgating the tax audit regulations described above. The second stage was the CBDT issuing accounting standards by notification in 1996. Two accounting standards were promulgated , one on accounting policy disclosure and the other on prior period items, extraordinary items and changes in accounting policies. Both tax accounting standards were similar to accounting standards already issued by the ICAI. The main provisions of tax accounting standard 1 and tax accounting standard 2 are outlined in appendices 26 and 27. *(Sikidar S., 1997, Chapter 8; Shah P.N., Chartered Accountant, vol xlv, July 1996, pages 11 to 18; Pandey T.N., Chartered Accountant, vol xliii, May 1995, pages 1459 to 146; Interview with senior Government official on 16th November 1998)*

Both intra-system activity and trans-system activity are seen in the promulgation of the regulations on tax accounting standards. Intra-system activity is seen mainly between the accounting profession and accounting regulations issued by the tax authorities. The DCA would also have been involved in the promulgation of the regulations on tax accounting standards. They would have been consulted by the CBDT and the Ministry of Finance on the proposals to issue tax accounting standards but were not directly involved in the process for promulgating these regulations, as in the promulgation of the tax audit regulations.

Trans-system activity is seen between social systems neighbouring the accounting system and the accounting system itself. In this case, trans-system activity is seen mainly, between the parliamentary system and the corporate system and accounting regulations issued by the tax authorities.

Both intra-system activity and trans-system activity are discussed below.

Intra-system activity

Interactions between the accounting profession and the tax accounting standards

Interactions between the Institute of Chartered Accountants of India (ICAI) and the tax accounting standards

From independence until 1995, accounting standard setting had been the domain of the ICAI and the accounting profession and this had been accepted as appropriate by the Government, the corporate sector and the other parties interested in financial reporting and accounting. Certainly until the 1990's, financial accounting issues had been left predominately to the ICAI and cost accounting issues had been left predominantly to the ICWAI. However a move away from this was seen in the 1990's with other institutions becoming involved in accounting issues. For example SEBI, the stock market regulator, became involved in promulgating regulations on cashflow statements and the Government proposed the setting up of a National Advisory Committee on accounting. *(Chapter 5; Chapter 9)*

The accounting profession, in particular the ICAI, felt very threatened by the moves by other institutions to become involved in accounting standard setting and this included the setting of tax accounting standards by the CBDT. The ICAI were particularly concerned that accounting standard setting would be taken out of their hands or that tax accounting standards would prescribe different accounting treatments to those prescribed by their accounting standards. Companies would then have to choose which standards to follow. It was likely that they would choose to follow tax accounting standards, as these would need to be followed for tax purposes and, hence, would be enforced more strictly than the accounting standards promulgated by the ICAI. If companies followed tax accounting standards, the enforcement and importance of accounting standards promulgated by the ICAI would be reduced and the power, status and influence of the ICAI would then also be reduced. *(Sikidar S., 1997, Chapter 8; Shah P.N., Chartered Accountant, Vol xlv, July 1996, pages 11 to 18; Pandey T.N., Chartered Accountant,*

Vol xliii, May 1995, pages 1459 to 146; Interviews with senior government officials on 10th November 1998, 16th November 1998 and 17th November 1998; Interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998)

The accounting profession, including individual chartered accountants, auditing firms and the ICAI, therefore argued strongly against the regulations giving the CBDT the power to issue accounting standards and these arguments included the following:

- the standard setting process was working reasonably well. Recently, the standards had been tightened up and enforcement was being addressed. Hence the ICAI should be allowed to continue with the standard setting.

- there was no need to increase the level of bureaucracy and government involvement in accounting, particularly in an era of liberalisation. Standard setting in the USA and the UK was undertaken by institutes similar to the ICAI and this was a suitable model which should be maintained.

- accounting standards issued by the tax authorities would only take into account the role of accounting in tax collection and hence would not consider all users of accounts. The due process used by the ICAI to promulgate accounting standards did take into account all the different users of accounts.

(Sikidar S., 1997, Chapter 8; Shah P.N., Chartered Accountant, Vol xlv, July 1996, pages 11 to 18; Pandey T.N., Chartered Accountant, Vol xliii, May 1995, pages 1459 to 146; Interviews with senior government officials on 10th November 1998, 16th November 1998 and 17th November 1998; Interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998)

These arguments were made both within the parliamentary system and outside the parliamentary system. Within the parliamentary system, which was used to promulgate the Finance Bill 1995, the accounting profession (the ICAI, individual chartered accountants and auditing firms) would have sent representations to the Government and the tax authorities in the three month feedback period on the Finance Bill 1995, which included the regulations giving the CBDT the power to promulgate accounting standards in its own right. The ICAI's arguments would also have been made in the pre and post budget

memorandum sent annually to the Government and the Ministry of Finance as well as in other representations sent to the Government and the tax authorities.

Outside the parliamentary process, the ICAI would have held meetings with the Government, the DCA and the CBDT and other tax authorities and members of parliament to argue their case that accounting standard setting should be left in the hands of the ICAI. In addition, they would also have made their arguments in the media for example in their own journal, the Chartered Accountant and in the newspapers and in other forums such as press releases, lectures and seminars. The ICAI and the auditing firms would also have lobbied members of parliament who were accountants or who were sympathetic to their view to present their case. *(Shah P.N., Chartered Accountant, Vol xlv, July 1996, pages 11 to 18; Pandey T.N., Chartered Accountant, Vol xliii, May 1995, pages 1459 to 146; Interviews with senior government officials on 10th November 1998, 16th November 1998 and 17th November 1998; Interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998)*

These arguments were not persuasive since the Government and the tax authorities considered that the regulations on tax accounting standards to be important for increasing tax revenue and for decreasing the power of the ICAI. Therefore, the regulations giving the CBDT power to promulgate tax accounting standards in their own right, went through the parliamentary system with little change.

The CBDT quickly used its power to issue tax accounting standards 1 and 2 in 1996, very much against the wishes of the ICAI. Thus the accounting profession, although active, were not influential in either the parliamentary process or in meetings with the Government and the tax authorities, in removing the provisions on tax accounting standards. *(Sikidar S., 1997, Chapter 8; Shah P.N., Chartered Accountant, Vol xlv, July 1996, pages 11 to 18; Pandey T.N., Chartered Accountant, Vol xliii, May 1995, pages 1459 to 146; Interviews with senior government officials on 10th November 1998, 16th November 1998 and 17th November 1998; Interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998)*

The other accounting professional bodies were not affected by the regulations on the tax accounting standards and were not involved in the process for promulgating these regulations.

Trans – system activity

Interactions between the Government and Ministry of Finance and the tax accounting standards

The Government and the tax authorires, the CBDT in particular, were very influential in the promulgation of the regulations on tax accounting standards.

As for the promulgation of the tax audit regulations, the Finance Minister set the economic and fiscal policies which would be followed by the Government, in his budget speech in 1995 and in the Finance Bill 1995. The Finance Minister worked closely with the CBDT and the Ministry of Finance to prepare the budget speech and draft the Finance Bill which included the power for CBDT to promulgate accounting regulations by notification. After the budget speech, there was a three month feedback period on the Finance Bill, followed by parliament debates in both Houses of Parliament, on the Finance Bill. Once again, the Ministry of Finance was responsible for steering the Bill through the parliamentary process. Again, as in the promulgation of the tax audit regulations, the CBDT and other tax authorities were instrumental in the promulgation of the provisions on the tax accounting standards. Despite representations made against the regulations on tax accounting standards by the ICAI and the corporate sector, little change was made to these provisions in the parliamentary process and the tax accounting regulations were promulgated in line with the wishes of the Government. *(Shah P.N., Chartered Accountant, Vol xlv, July 1996, pages 11 to 18; Pandey T.N., Chartered Accountant, Vol xliii, May 1995, pages 1459 to 146; Interviews with senior government officials on 10th November 1998, 16th November 1998 and 17th November 1998; Interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998)*

Thus the Government, in particular the Finance Minister, and the CBDT decided on the importance of the tax accounting provisions, included them in the 1995

budget speech and Finance Bill 1995 and steered the provisions through Parliament. The Government and the CBDT therefore were very important and influential in the diffusion phase of this promulgation of the regulations on the tax accounting standards.

Once the regulations on tax accounting standards were promulgated and the CBDT gained its mandate to issue tax accounting standards by notification, they used these power to promulgate tax accounting standard 1 and tax accounting standard 2 very quickly in 1996. These regulations were issued directly by the CBDT and there was no interaction with any of the parties interested in the tax accounting standards. There was no need for the CBDT to go through due process or the parliamentary process, since it had been given power by Parliament to issue accounting standards in its own right. The Government and the CBDT were therefore the most influential parties in the diffusion phase of the promulgation of the regulations on tax accounting standards. *(Sikidar S., 1997, Chapter 8; Shah P.N., Chartered Accountant, Vol xlv, July 1996, pages 11 to 18; Pandey T.N., Chartered Accountant, Vol xliii, May 1995, pages 1459 to 146; Interviews with senior government officials on 10th November 1998, 16th November 1998 and 17th November 1998; Interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998)*

Interactions between the corporate sector and the tax accounting standards

The corporate sector, in common with the accounting profession, was very much against the regulations giving the CBDT the power to issue tax accounting standards. They too argued against the tax accounting standards, both within the parliamentary process and outside parliament. Within the parliamentary process, they submitted representations to the Government and the tax authorities in the three month feedback period on the Finance Bill and lobbied members of parliament to argue their case in the parliamentary debates. These representations and the lobbying took place mainly through chambers of commerce and trade associations. In addition the corporate sector too held meetings with the Government and the tax authorities to try and persuade them to

remove the regulations on tax accounting standards. They also argued their case in the media, as did the ICAI.

The main arguments were similar to those made by the ICAI and included:

- that the standard setting process of the ICAI was well established and quite successful and hence should be allowed to continue
- accounting standard setting by the tax authorities would add another layer of regulations for the corporate sector to follow, which was unnecessary and inappropriate in a liberalised and open economy.
- it was unclear whether accounting standards set by the tax authorities would actually improve tax collection and the regulation might lead to increased costs for companies with no clear benefits to the exchequer
- that the tax audit was enough to ensure that tax was collected speedily and efficiently.

(Sikidar S., 1997, Chapter 8; Shah P.N., Chartered Accountant, Vol xlv, July 1996, pages 11 to 18; Pandey T.N., Chartered Accountant, Vol xliii, May 1995, pages 1459 to 146; Interviews with senior government officials on 10th November 1998, 16th November 1998 and 17th November 1998; Interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998; Interviews with senior accounting personnel in companies on 27th October 1998, 29th October 1998, 2nd November 1998 and 5th November 1998)

The corporate sector were against any increase in the regulations they had to follow and may also have been concerned that they would not be able to influence the tax accounting standards whereas they had been able to influence the accounting standards issued by the ICAI. This influence had taken place in the due process based system for the promulgation of the accounting standards issued by the ICAI and also through their auditors, the large auditing firms who influenced the ICAI, as discussed in chapter 11.

These arguments were not accepted by the Government and the CBDT and the regulations were promulgated in line with the wishes of the Government and the CBDT. Thus the corporate sector were unable to influence the tax accounting standards provisions, despite much lobbying activity on their part.

Interactions between Parliament and the tax accounting standards

Once again, as in the tax audit provisions, Parliament had the opportunity to influence the regulations on tax accounting standards since they were included in the Finance Bill 1995, which was promulgated through the parliamentary process. This included introduction in Parliament by the Finance Minister and parliamentary debates on the Bill in both Houses of Parliament. The regulations on tax accounting standards were supported by Parliament since members of parliament agreed with the government that tax collection needed to be improved and tax accounting standards were needed. Hence the regulations were promulgated in line with the wishes of Government and the tax authorities, with little change made to the regulations by Parliament. *(Shah P.N., Chartered Accountant, Vol xlv, July 1996, pages 11 to 18; Pandey T.N., Chartered Accountant, Vol xliii, May 1995, pages 1459 to 1460; Interviews with senior government officials on 10th November 1998, 16th November 1998 and 17th November 1998;Interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998)*

Once the regulations giving the CBDT the power to issue tax accounting standards, Parliament no longer had the opportunity to influence the accounting standards that were promulgated by the CBDT.

The Reaction Phase

The first two tax accounting standards notified by the CBDT on 26th January 1996, were on accounting policy disclosure and on extraordinary items, exceptional items and changes to accounting policies and were similar to those issued by ICAI. The tax accounting standards would apply to the 1997/1998 tax years and all subsequent tax years for all companies. The corporate sector stated that they would be following the tax accounting standards even though they were not happy at their promulgation. In India, the system of promulgating regulations is such that interested parties try and influence statutory regulation, before it is promulgated. Once the regulations are promulgated and become law,

all companies follow them in a very uniform way. Companies do not register any protest against the regulation by not following the regulations. This is very much in line with the culture of the country and is seen in the survey of 1996 accounts and in the survey of accounts from the 1950's. *(Sikidar S., 1997, Chapter 8; Interview with senior government official on 16th November 1998; Interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998; Interviews with senior accounting personnel in companies on 27th October 1998, 29th October 1998, 2nd November 1998 and 5th November 1998; Chapter 5)*

Instead, lobbying takes place by the parties interested in the regulations, to try and change the regulations if they are thought to be too onerous or ineffective. Thus the reaction phase is generally not openly seen.

The reaction phase does occur but slowly and over a long period of time. It is expected that both intra-system activity and trans-system activity will be seen in the reaction phase, as is seen in the diffusion phase, but these activities are not visible and therefore not easy to analyse. However, it is expected that the same parties who lobbied and tried to influence the regulations on tax accounting standards will again be active in the reaction phase i.e. mainly the accounting profession, in particular the ICAI, and the corporate sector mainly through chambers of commerce and trade associations. It is expected that both the ICAI and the corporate sector met with officials of the DCA, the tax authorities (Ministry of finance, Department of Revenue and CBDT), members of the Government and members of parliament to continue to argue their case against tax accounting standards.

The accounting profession and the corporate sector were particularly worried that the tax authorities would promulgate tax accounting standards, which would conflict with the accounting standards issued by the ICAI. For example, there was some discussion by the tax authorities, that they would issue standards on the capitalisation of interest which were different to those issued by the ICAI and so this fear was not unfounded. *(Sikidar S., 1997, Chapter 8; Interviews with senior Government officials on 10th November 1998 and 17th November 1998; Interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November*

1998 and 18th November 1998; Interviews with senior accounting personnel in companies on 27th October 1998, 29th October 1998, 2nd November 1998 and 5th November 1998)

The lobbying by the accounting profession and the corporate sector did have some success. The regulations giving the CBDT power to issue tax accounting standards were not changed. However, an informal understanding that the tax authorities would not issue accounting standards which conflicted with the accounting standards issued by the ICAI, was reached. This understanding may even have been reached before the promulgation of the first two tax accounting standards since these were almost identical to accounting standards issued by the ICAI. This was probably the best outcome that the corporate sector and the ICAI could have hoped for.

In fact, the tax authorities did not issue any further tax accounting standards after 1996 which the ICAI were very happy with. That the CBDT did not promulgate any further tax accounting standards may also have been, in part, due to other developments within the Government. These included a move away from the view that tax accounting standards were the best way forward. Instead, the setting up of a National Advisory Committee on Accounting Standards was included in the Companies Bill 1997. It was expected that this would be set up, once the Companies Bill 1997 was promulgated, to take over standard setting and would take into account all the uses of accounting, including tax considerations. The attempt to promulgate the Companies Bill 1997 is discussed in chapter 9. *(Kale Y.M., Chartered Accountant, Vol xlv, March 1996, pages 3 to 4; Vishwanath T.N., Chartered Accountant, Vol xlv, February 1996, pages 78 to 83; Interviews with senior Government officials on 10th November 1998 and 17th November 1998; Interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998; Chapter 9)*

Culture and Social Context

Culture and social context are, once again, seen to be important in the promulgation of the regulations on the tax audit provision and the tax accounting standards regulations.

Culture and social context are important in the source phase of both changes. Tax collection has always been a Government priority in India. The corporate tax base in India has been quite narrow with most of the tax being collected from relatively few companies, the largest companies in India. This has been compounded by small and medium sized companies in the corporate sector which have not contributed to the tax yield, partly due to poor performance resulting from protection from competitive pressures by the Government and partly due to tax avoidance, evasion, fraud and corruption. Indeed, both of the changes to the accounting system were initiated to deal with these problems.

The tax audit was introduced to increase tax yields and improve the efficiency of tax collection in the 1980's by the Government and the tax authorities. The tax audit regulations were introduced incrementally. They were initially applied to just the larger companies who were paying their taxes anyway. However the provisions were later applied to some of the other companies, though not to the small companies in the economy for whom the tax audit would not be too expensive and perhaps inhibit entrepreneurial talent.

The regulations on tax accounting standards too were initiated to help improve tax yields and collection. The tax authorities, mainly the CBDT, considered that the companies had too much flexibility in choosing their accounting policies and that this was affecting their tax liabilities. Therefore, they initiated the promulgation of regulations, in conjunction with the Government, in particular the Finance Minister, which gave them power to promulgate accounting standards in their own right.

In both cases, the source of the changes related to general economic and social concerns of the Government. In both the changes, these related to taxation issues, in particular to increase taxation collection, increase the efficiency with which tax was collected and to reduce taxation avoidance, evasion and fraud. In addition in the second change, the promulgation of regulations on tax accounting standards, there was concern over the power of the ICAI and the auditing profession. Perhaps part of the reason for promulgating these regulations was to reduce the flexibility with which the corporate sector chose their accounting polices and reduce the power of the ICAI, who issued accounting standards to regulate the corporate sector in addition to the accounting regulations of the Companies Act 1956.

The importance of culture and social context is also seen in the diffusion and reaction phases of the changes. Culture and social context, once again, affected the institutions and processes involved in the promulgation of the accounting changes. Once again, the importance of Government involvement in accounting regulation is seen, with the Government and the tax authorities being very influential in both changes. Strong Government involvement in accounting has always been an important feature of the accounting system in India and is very much in line with the culture and social context of India.

In the regulations on tax audits and tax accounting standards, the Finance Minister of the Government and the tax authorities were directly responsible for promulgating the regulations. In addition, the CBDT was given the mandate to issue accounting standards in their own right which they used in 1996 to promulgate tax accounting standards 1 and 2. There was therefore strong direct government involvement in promulgating regulations that affected the accounting system. This was seen in the process of promulgating the regulations and with CBDT promulgating regulations in their own right, despite liberalisation of the economy in the 1990's.

The parliamentary system was also again chosen as the most appropriate means of promulgating the regulations. In the first change, the tax audit provisions were

included in the Finance Bill 1984 which was promulgated using the parliamentary system. In the second change, the regulations giving the CBDT power to issue regulations in their own right were included in the Finance Bill 1995 and promulgated using the parliamentary system. Statutory legislation, promulgated through the parliamentary system is very much expected in a country with the cultural characteristics of India and is used frequently to promulgate changes to the accounting system in India.

The accounting system in India is one in which both statutory regulation and regulation by the accounting profession is expected. This is indicated in the promulgation of the tax audit and the tax accounting standards. In the tax audit provision, the ICAI and the auditing profession who are regulated by the ICAI, are given more authority than previously by introducing the regulation for members of the ICAI to perform tax audits, in addition to performing statutory audits. This increased the authority of the ICAI and gave it more power and status than it had had before. Thus the ICAI and the chartered accountants are seen to have been very active and influential in regulating accounting within the accounting system in India, alongside Government control of accounting using statutory legislation.

The authority of the ICAI and auditing profession was also affected by the second change, the promulgation of regulations on tax accounting standards. By the 1990's, the ICAI were actively involved in accounting regulation through their standard setting process which had been initiated in 1977, as discussed in chapter 11. Indeed, the Government and tax authorities considered that this might not be appropriate since accounting standards had social and economic consequences and hence should not be left entirely to the ICAI. This was one of the reasons for promulgating the regulations on the tax accounting standards. Despite this change, the ICAI still remained an important regulatory institution in the accounting system, albeit with its status reduced somewhat.

Finally, culture and social context are also seen to be important in the reaction phase of both changes. The cultural characteristics of India indicate that

regulations will be followed in a uniform way and this is indeed what is seen, in both tax related changes. Culture therefore may be a contributory factor in the lack of a visible reaction phase to promulgation of the regulations on the tax audit and on the tax accounting standards. The reaction phase does however take place and interactions do occur between the main parties affected by the regulations and the Government and the tax authorities to try and influence the regulations after they have been promulgated. In the first change, both the ICAI and the corporate sector were the main interested parties. The ICAI were happy with the regulations and supported them. The corporate sector was not happy with the regulations and argued against the provisions but with little effect. In the second change, both the corporate sector and the ICAI argued against the regulations and were able to reach an informal understanding with the tax authorities for them not to issue accounting standards which conflicted with the accounting standards issued by the ICAI.

Politics and accounting change

From the above, it can be seen that the process of accounting change is surrounded by political processes and is political in several ways. This is seen in both the promulgation of the tax audit regulations and the promulgation of the regulations on tax accounting standards.

As discussed in chapters 6 to 12, accounting is seen to be political since the major accounting regulations are included in statutory legislation, in this case, the annual Finance Bills, which are promulgated through the parliamentary system, and hence influenced and affected by Parliament. Parliament had the opportunity to influence the regulations on tax audits and tax accounting standards but chose not to change the provisions in any major way during the parliamentary process.

Accounting is also political in that there is strong Government involvement in accounting. There is strong Government involvement in the promulgation of the

tax audit regulations with the Finance Minister and the tax authorities initiating the change and working closely together to promulgate the regulations. These regulations were not welcomed by the corporate sector who lobbied against the provisions but were not successful due to the perception by the Government that these regulations were very important for collection of taxes.

Strong Government involvement is also seen in the promulgation of the regulations on tax accounting standards. Once again, there was strong Government involvement in the promulgation of regulations on tax accounting standards with the Finance Minister and the tax authorities initiating the change and working closely together to promulgate the regulations. In addition, strong Government regulation is seen to be increasing rather than decreasing, despite liberalisation. The Government promulgated regulations which gave the CBDT a mandate to issue accounting regulations in their own right, rather than going through the parliamentary system. Parliament therefore no longer had the opportunity to influence the tax accounting standards. Other parties who were interested in the tax accounting standards, too, lost the opportunity to influence the regulations as they were not promulgated through the parliamentary system.

Finally, the whole process of promulgating accounting regulations can, again, also be seen as the outcome of debates between the different parties interested in the provisions on tax audits and tax accounting standards. In the regulations on the tax audit, the debate, representations and negotiation took place mainly within the parliamentary system but also took place outside the parliamentary system. The debates took place in both the diffusion and the reaction phase of the change, although it was not visible in the reaction phase. In the tax audit regulations, little activity is seen on behalf of the ICAI who were happy with the provisions and the main interaction was trans-system activity between the corporate sector and the Government and the tax authorities to try to remove the regulations. This was not successful due to the importance placed on the tax audit provisions by the Government.

In the regulations on tax accounting standards, the debate, representations and negotiation took place both within the parliamentary system and outside the parliamentary system, as for the tax audit regulations. The debates took place in both the diffusion and reaction phases between the corporate sector, the ICAI, the Government and the tax authorities. The interests of the accounting profession and the corporate sector coincided and they both argued against the regulations. However they were not successful in the diffusion phase and the regulations were promulgated in line with the wishes of the Government.

In the reaction phase, the debate and representations, although not visible, did take place in meetings between the corporate sector and the ICAI and the Government and tax authorities. The corporate sector and the ICAI did have some success in limiting the operation of the regulations on tax accounting standards by obtaining an informal understanding limiting the use of tax accounting standards in practice.

Summary and Conclusions

As proposed in the theoretical framework outlined in chapter 3, the promulgation of the regulations on the tax audit and tax accounting standards can be analysed into source, diffusion and reaction phases. Both changes are initiated by events and institutions outside the accounting system. In both cases, the changes are initiated by the Government, in particular the Finance Minister, and the tax authorities to increase tax revenue, make tax collection more efficient and reduce tax evasion, avoidance and corruption. These changes to the accounting system are initiated from outside the accounting system and relate to economic concerns, rather than one change stimulating event causing the changes.

The diffusion and reaction phases of the changes are composed of intra-system activity and trans-system activity. The main intra-system activity, in both the diffusion and reaction phases, occurred between the accounting profession,

mainly the ICAI and the regulations on tax audits and tax accounting standards. The main trans-system activity, again in both the diffusion and reaction phases, occurred between the parliamentary system and the corporate sector and the regulations on tax audits and tax accounting standards.

Once again, it is seen that culture and social context are important in all three phases of the change and the whole process of change, including accounting change, is surrounded by political processes. The economic and social context of the country determines the issues and problems which need to be tackled and also the institutions and processes used to tackle these issues and problems. In the source phase, the changes are initiated for economic reasons – to increase tax revenue and to improve the system for collecting tax. Tax collection has always been a problem in India due to the poor economic position many of the companies, partly created by the economic policies of the Government, and due to problems such as tax evasion and corruption which are prevalent.

In the diffusion phase of both changes, statutory legislation, the Finance Bill promulgated through the parliamentary system, was used to promulgate the regulations and amend the Income Tax Act, 1961 to include the regulations on the tax audit and the tax accounting standards.

The Government also again retained strong controls over the corporate sector and the ICAI in both changes with strong Government involvement in the process of change as well as strong government control, via the CBDT, introduced in the regulations. In fact, the Government increased its direct control over the corporate sector and the ICAI by promulgating the regulations on the tax accounting standards in the 1990's. This is very much in line with the social and cultural context of India, and is seen despite liberalisation of much of the rest of the economy.

Accounting is also seen to be political in many senses. Accounting change is influenced by Parliament and Government. The parliamentary system is used to promulgate the regulations and there is strong government involvement in the

regulations. This is seen in both the process for promulgating the regulations and with the CBDT being given power to promulgate tax accounting standards in their own right.

In addition, accounting change is seen to be the result of interactions between the different parties interested in accounting. These parties are identified as the Government, in particular the Finance Minister, the CBDT and other tax authorities, Parliament, the corporate sector and the accounting profession, in particular the ICAI. All of these try and influence accounting change in both the diffusion and reaction phases of the changes. The most successful parties are seen to be the Government and the tax authorities.

As outlined above, both cultural and political processes are important in influencing accounting change and the theoretical framework proposed in chapter 3 is shown to be useful in analysing the promulgation of the tax audit regulation and the regulations on the tax accounting standards.

Chapter 14

Summary and Conclusions

The aim of the exploratory research in this thesis has been to analyse the influence of culture and politics on accounting change in India since independence. Culture and politics, as discussed in chapter 2, have been identified in the literature as being important influences on accounting, which need further study. Culture has been defined in the sociological and anthropological literature as learned or acquired behaviour resulting from man's response to his environment which, once acquired, then conditions man's response to his social environment. Culture influences all social systems including accounting since it influences:

"a the norms and values of such systems

b the behaviour of groups in their interactions within and across the system"

(Harrison G. and McKinnon J.L., 1986, page 239)

Politics too has been identified as being an important influence on accounting. Accounting is political in three main senses:

- accounting is influenced by Government
- accounting regulations are promulgated using the parliamentary system
- accounting change is the result of negotiations between different parties interested, and involved in, accounting

As well as cross sectional analyses of the influence of culture and politics on accounting, in-depth historical analyses of accounting change have been identified as being important. In addition, more studies are needed of non anglo-saxon, non western countries, since most of the work on culture, politics and accounting has looked at developed countries in the west. This research, therefore, provides a historical study of the influence of culture and politics on accounting change in India, an important developing country which has not been studied in depth. This has been done by identifying the main accounting changes

in India from independence to 1998 and analysing these using a theoretical framework proposed in chapter 3. The proposed theoretical framework is based on the work of McKinnon *(1986)* and Gray *(1988)* and is expected to facilitate the analysis of culture and politics on the process of accounting change within historical studies of accounting change. In the framework, the accounting system is viewed as one of the social systems in the country, providing information for financial decision making and providing a tool for social and economic management. The accounting system comprises the authorities and institutions which formulate the regulations and the interactions between the different authorities and institutions within the system. Culture is seen as affecting all the social systems in the country, including the accounting system.

Using the framework, accounting changes are identified and analysed into three phases, a source phase, a diffusion phase and a reaction phase. In the source phase, change to the accounting system is set in motion by events arising from outside the accounting system. The diffusion phase of any accounting change looks at how change is dispersed and accommodated within the system and the reaction phase of any accounting change looks at how the accounting system is modified subsequent to the diffusion phase. The diffusion phase and the reaction phase encompass both intra-system activity, activity between the different components of the accounting system, and trans-system activity, activity between the accounting system and its neighbouring systems, and both types of activity determine the outcome of any change. Intra-system activity is expected to take place between the main regulatory authorities within the accounting system and these are identified to be the Department of Company Affairs (DCA) and the three professional accounting institutes, the Institute of Chartered Accountants of India (ICAI), the Institute of Cost and Works Accountants of India (ICWAI) and the Institute of Company Secretaries of India (ICSI). Trans-system activity is expected to take place between the accounting system and the systems neighbouring the accounting system which are expected to have an interest in accounting. These are expected to include the legal system, the economic system, the political system, the international system, the financial system and the corporate sector.

The culture of the country affects all social systems and all three phases of the accounting change. It is expected that both nation-specific cultural values and universal culture values will be important in the analysis of accounting change, affecting both accounting values and the accounting system. Culture is not treated as a single separate factor that affects accounting in isolation; instead it is viewed as affecting all the systems in the country including the accounting system and the systems neighbouring the accounting system. In addition, political processes are expected to influence the accounting system. The outcome of accounting change is expected to be influenced by the interactions between the different parties interested in accounting and accounting change is expected to be influenced by Government and by the parliamentary process.

As discussed in chapters 3 and 5, the main changes to the accounting system in India have been identified to be:

- the promulgation of the Companies Act 1956 and changes to this Act
- the setting up of the accounting profession in India, in particular the ICAI and the ICWAI
- the setting up of the standard setting process by the ICAI
- the promulgation of tax audit requirements and the promulgation of tax accounting standards by the Central Bureau of Direct Taxes (CBDT)

These changes are analysed in chapters 6 to 13, using the theoretical framework described in chapter 3 and data for the research is obtained from:

- literature on India
- a survey of accounts of companies for the year ended in 1996
- a survey of accounts of companies from the 1940's and 1950's
- an analysis of "The Chartered Accountant", the journal of the Institute of Chartered Accountants of India
- a review of key parliamentary reports and parliamentary debates on changes to the accounting system involving legislation
- interviews with the main parties interested and involved in accounting in India

The data is used to both identify the main changes to the accounting system since independence and to analyse the influence of culture and politics on the accounting changes chosen for study. The main cultural and social values, the main economic and political institutions that are expected to influence accounting and the development of the social, political and economic context in India since independence are outlined in chapter 4. In chapter 5, the accounting values seen within the accounting system of India are discussed. Data from both these chapters, as well as the sources of data outlined above, is used extensively in the analysis of the accounting changes given in chapters 6 to 13.

Main conclusions and findings of the research

The main conclusions and findings from the research, both an assessment of the proposed theoretical framework and the influence of culture and politics on accounting in India are discussed below.

Assessment of the theoretical framework proposed in the thesis

The proposed theoretical framework provides a useful framework for studying the influence of cultural and political processes on accounting change. Using the framework, it is possible to analyse accounting change into source, diffusion and reaction phases.

In the source phase, change is initiated usually from outside the system and for social, political and economic reasons. In all the changes, the Government is seen to be important in initiating changes to the accounting system, predominantly for economic concerns such as rapid economic development, control of economic wealth and increase in taxation revenue. International influences, in particular accounting developments in Britain, too are seen to influence the source of accounting change in India. For example, changes to British Company Law were influential in changing the Companies Act 1956 in India and the Institute of Chartered Accountants of England and Wales (ICAEW) influenced the setting up of the ICAI in India and the standard setting process of

the ICAI. British influence on India is very much expected due to the long period of colonisation of India by Britain.

In the diffusion phase of all the accounting changes, intra-system activity and trans-system activity is seen. Intra-system activity, activity between the regulatory bodies within the accounting system, is seen between the DCA, the ICAI, ICWAI and the ICSI, which are identified to be the main institutions within the accounting system. Intra-system activity takes place between these institutions and accounting regulations, both within the parliamentary system which is used to promulgate many accounting regulations and directly between these institutions. Trans-system activity takes place between the accounting system and neighbouring social systems. The main systems which neighbour the accounting system and which most affect, and are most affected by, the accounting system are identified to be the parliamentary system, the corporate system, the taxation system, the legal system, the financial system, in particular the stock exchanges and their regulators and the international system.

In some of the changes, a reaction phase is also seen and intra-system activity and trans-system activity, as for the diffusion phase, determines the final outcome of the change in the reaction phase.

Culture affects all institutions and social systems. Cultural values affect the accounting values within the accounting system, the institutions within the accounting system and the systems and institutions neighbouring the accounting system. The cultural values of India have been identified by Hofstede *(1980)* to be low individualism, low uncertainty avoidance, high power distance and high masculinity. Nation specific cultural values in India include a collective society in which the individual is less important than the group, strong hierarchy and high masculinity seen in all the social systems including the joint family system and the caste system and religious and philosophical beliefs which help to deal with uncertainty.

The analysis of the accounting changes in chapters 6 to 13 show that the proposed theoretical framework does help in the analysis of accounting change

within a historical study of accounting. The framework helps to focus on the main institutions and social systems involved in the process of accounting change and the interactions between the institutions and systems. The framework helps in analysing the influence of culture on accounting and also enables the investigation of political processes on accounting. The main findings from the use of the theoretical framework are discussed in the next section.

The framework has some limitations which have been identified as follows:

- the changes are relatively easily broken down into source and diffusion phases but the reaction phase is not always visible. Hence, it is not always possible to analyse all the accounting changes into all three phases. The lack of a visible reaction may also, in part, be explained by the cultural values in India.

- the source of the change generally comes from outside the accounting system but is not necessarily one intrusive event such as war. In all but one of the changes analysed in this thesis, the reasons for initiating change to the accounting system came from outside the accounting system and related to socio-economic concerns. However, in one of the changes, the setting up of standard setting by the ICAI, change was initiated from within the accounting system to improve the regulation of accounting measurement and disclosure practices by the ICAI and to improve the status and profile of the ICAI, both nationally and internationally. Thus, while most accounting change is started from outside the accounting system, accounting change can also be started within the accounting system, although this is less common.

- accounting change is very complex and the full complexity of the change process is not captured using the framework. This limitation is applicable to any framework or model. Some simplification is inevitable, whatever model or framework one uses.

- it is not always clear-cut where the diffusion phase ends and where the reaction phase starts. For example, in the promulgation of the Companies Bill 1997, exactly where the diffusion phase ends and where the reaction phase starts is not clear. However, since the same processes are present in both the diffusion phase and the reaction phase of the changes, the overall insights and interpretation gained by using the framework are not reduced significantly by this limitation.

- the different parties involved in the process of accounting change are treated as homogeneous groups. In particular, the accounting profession and the corporate sector are treated as single groups who all have the same interests. This is not always appropriate. For example, the auditing profession in India is made up of Indian firms and international auditing

firms who have different interests. However, the auditing firms do have many concerns that are similar and which unite them. For example, all the members of the accounting profession would prefer self regulation over regulation by the Government. Thus, for this exploratory research, the groupings identified are appropriate and do provide valuable insights into the main parties involved in process of accounting change.

Despite the limitations of the framework outlined above, the framework is, on the whole, useful in helping to analyse the process of accounting change in India and in analysing the impact of culture and politics on accounting change. The main findings from an analysis of accounting change in India using the framework are discussed below.

Conclusions relating to the influence of culture and politics on accounting change

Culture and Accounting

As outlined above, the cultural values of India have been identified by Hofstede *(1980)* to be low individualism, low uncertainty avoidance, high power distance and high masculinity. Nation specific cultural values in India include collectivism and hierarchy, which are seen in all the social systems in India including the joint family system and the caste system. Government control is seen in all aspects of social and economic life and is expected to be important in accounting too. In addition, many systems in India were introduced by the British, for example the legal system, the civil service and the political system. These are expected to be important in regulating the accounting system, which is also expected to be directly affected by the British influence.

Based on these universal and nation specific cultural values, it is expected that the accounting values in India will show elements of both uniformity and flexibility, elements of both professionalism and statutory control, elements of both secrecy and transparency and elements of both optimism and conservatism.

The cultural and accounting values indicate that the accounting system in India will show the following characteristics:

- strong Government involvement in accounting will be seen.
- authority for the accounting system will be a combination of statutory and professional authority, with both strong statutory control and strong professional control being present in the accounting system.
- both uniformity and flexibility will be seen in the application of accounting practices and regulations.
- there will be mixed measurement practices, some showing optimism and some showing conservatism.
- there will be mixed disclosure practices, with a mixture of secrecy and transparency. It is expected that some areas will be very well disclosed but other areas will have virtually no disclosures.

In addition, the process of accounting change is also influenced by politics with government involvement in accounting, accounting regulations being promulgated by the parliamentary system and the outcome of accounting change being the result of negotiations between the different parties interested in accounting. The actual practices seen in the accounting system and the main findings of the research are discussed below.

The role of the Government in accounting

In line with the cultural values outlined above, Government involvement in the accounting system is expected and is, indeed, seen in the accounting system and in all the changes analysed. In the promulgation of the Companies Act 1956, and the changes to the Companies Act 1956, discussed in chapters 6 to 9, Government control over accounting is seen in several ways. There is strong Government involvement in the process for promulgating the Companies Act 1956 and the Companies Act itself contains provisions which give the Government strong control over the corporate sector and over accounting, through the DCA and the Company law Board (CLB). The DCA is identified as the main regulatory institution in India for regulating accounting and the corporate sector.

The involvement of the Government via the DCA in the process of changing the Companies Act is seen in all the phases of the changes to the Companies Act and in all the time periods. Indeed Government involvement in the changes to the Companies Act increases over time, even when liberalisation of the economy is started in the late 1980's and when India's economy is liberalised from 1991. Thus, despite moves towards opening up of the economy, Government control in the accounting system remains strong in India with provisions for setting up a National Advisory Committee for Accounting standards and some legal recognition for accounting standards in the Companies Bill 1997 and the Companies (Amendment) Ordinance 1998.

Strong Government control is also seen in the analysis of the accounting profession in India. The Government was directly involved, and played an important role, in the setting up of the accounting profession in India. The Government was actively involved in the setting up of the ICAI in 1949 and the ICWAI in 1959. The Ministry of Commerce was important in influencing both the diffusion and reaction phases of the setting up of the ICAI. The Ministry of Commerce very much shaped the structure of the ICAI. It is likely that, without the involvement of the Ministry of Commerce, the ICAI may not have been set up. The setting up of the ICAI was initiated by the Indian accountants on the IAB, who wanted to set up an accounting body similar to the ICAEW in Britain, after independence. However, such a professional body was not consistent with the cultural values of India. Instead, the process of setting up the ICAI and the structure of the ICAI were influenced by the cultural and social values of India, rather than the British ideal of an independent accounting profession. The Government was very involved in the process of setting up the ICAI which was established using statutory legislation, the Chartered Accountants Act 1949, which was promulgated using the parliamentary system. A council was set up to run the ICAI which included not only chartered accountants but also representatives of the Government and the corporate sector. The Government was also important in influencing the ICAI in the reaction phase, on the issue of reciprocity and cost accounting.

The Government, via the Ministry of Commerce, was also important in all the phases of the setting up of the ICWAI in 1959. The Government initiated the setting up of the ICWAI in the source phase and was important in mediating between the ICAI and the ICWAI in the diffusion and reaction phase of the change.

As well as the Government involvement in the accounting system with the DCA being a key regulatory body within the accounting system, Government involvement in the accounting system is also seen by the tax authorities, which are under the Ministry of Finance. This is seen in two ways. Firstly, the CBDT and senior officials of the Ministry of Finance and the Ministry of Commerce were involved in the resolution of disagreement on the disciplinary process of the ICAI, which occurred during the setting up of the ICAI in 1949. Secondly, the CBDT and the Ministry of Finance were involved in the promulgation of the tax audit requirements in 1985 and the promulgation of tax accounting standards in 1996. These regulations were initiated by the tax authorities and the Ministry of Finance in the source phase to tackle the problem of low tax revenue and the narrow tax base in India and the CBDT and the Ministry of Finance were the most important parties in the diffusion and reaction phases of the change.

As well as the formal involvement of the Government in the accounting system, informal involvement in accounting matters by the DCA is also seen. Informal interactions are seen in the diffusion phase of the setting up of the ICAI, in the diffusion phase of the setting up of the standard setting process and in the reaction phase of the promulgation of tax accounting standards. In the setting up of the ICA, meetings between the Ministry of Commerce, the CBDT and the Ministry of Finance and senior accountants on the IAB were held to resolve concerns over the proposed disciplinary process of the ICAI.

Informal and indirect involvement in ICAI matters by the Government was also seen in the setting up of the standard setting process by the ICAI in 1977, as discussed in chapter 11. The setting up of the standard setting process was instituted by the ICAI to promulgate accounting standards to regulate measurement and disclosure practices by the corporate sector in response to

criticisms of the ICAI in this field. These criticisms included the lack of uniformity in accounting practices, which made the comparison of the financial reports of different companies difficult and the variety of accounting practices available to companies, making it possible for some managements to manipulate earnings. This was the only change in which statutory legislation, promulgated through the parliamentary system, was not used and in which there was no direct involvement in the process of change by the Government. However, the Government would have been consulted about the standard setting process, by the ICAI, in the early stages of the decision of the institute to set up such a process, and had the Government not been in favour of this, it is unlikely that the ICAI would have continued with standard setting. Thus, as well as direct influence over the ICAI, the Government also influenced the ICAI indirectly, which is very much in line with the cultural and social context of India.

In the promulgation of tax accounting standards by the CBDT, informal interactions between the ICAI and the CBDT and Ministry of Finance limited the promulgation of tax accounting standards by the CBDT. Indeed, personal, informal interactions are often used to make representations to the Government and this may, in part, explain the lack of visible reaction in some changes. This practise is consistent with cultural and social practises in India such as the kinship favour system.

Statutory control and professional control of accounting

As well as Government involvement in the accounting system in India, both statutory and professional control of accounting is seen in India. Statutory regulation is seen in all but one of the accounting changes and includes the incorporation of accounting regulation in the Companies Act, the setting up of professional accounting bodies using statutory legislation and tax accounting requirements included in the annual finance bill.

The accounting profession too is also important in regulating accounting, with three professional accounting institutes in India which regulate financial reporting, auditing, cost accounting and company secretarial practice.

Statutory control of accounting

The Companies Act 1956

Statutory legislation via the Companies Act 1956 is the main form of regulation of the corporate sector in India. The Companies Act was inherited at independence from the British and was retained as an important means of regulating the corporate sector. India chose to retain a means of regulation that was consistent with the culture of the country and amended this to fit in with the social, economic and political aims of the India, where previously it had been enacted in the interests of Britain.

The Companies Act 1956 contains the main accounting regulations in India and all companies follow these regulations in India in a very uniform manner. The Companies Act 1956 and changes to the Companies Act 1956 are promulgated using the parliamentary system and thus trans-system activity between accounting regulation and the parliamentary system is seen. Intra-system activity too is seen between the DCA and the Companies Act. The Government, in particular the DCA, has been the most important influence, both directly and indirectly on the promulgation of the Companies Act 1956 and the changes to the Companies Act in 1974, 1988 and 1997.

The Companies Act and the accounting regulations in the Companies Act have always reflected the social, political and economic aims and needs of India, in particular to facilitate rapid economic development. From independence to the mid 1980's, the aims of the Companies Act supported the socialist ideals in the country and included controlling the concentration of economic wealth and trying to ensure fairness and equity between the different stakeholders involved in the corporate sector (capital, labour and management). Key accounting regulations were included in the Companies Act since accounting was seen to be

a tool to aid social and economic development and, as such, important for society as a whole and not just accountants.

These concerns are seen in promulgation of the Companies Act 1956 and the Companies (Amendment) Bill 1974. Both pieces of legislation increased the regulation of the corporate sector, including the accounting requirements to be followed by the corporate sector, in line with increasing regulations in all areas of the economy. The source of these changes to the Companies Act 1956 arose from the social, economic and political context of India and included economic development with social justice and equity amongst the different stakeholders in the corporate sector. For example, in the Companies Act 1956, accounting regulations included:

- specified formats for balance sheets to help in the comparison of financial information to ensure that stakeholders had information to be able to participate in the management of the corporate sector and to facilitate the preparation of financial information, possibly due to the shortage of accountants after independence.
- items to be included in the profit and loss account, again to improve the comparability of financial information and to ensure that important information was not left out of the profit and loss account, thereby making the financial information misleading
- provisions to ensure the independence of auditors. Auditing was perceived as important for the economic development of the country, but would only be effective if auditors could be independent of the companies they audited.

The Companies (Amendment) Bill 1974 included the following provisions, all of which reflected the social and economic concerns of the country:

- disclosures on conservation of energy, modernisation, research and development, foreign exchange and import and export policies
- disclosures on related party transactions including the disclosures on the employment of relatives and their qualifications, and contracts between directors and the companies that they managed
- disclosures on company licenses and the utilisation of these licenses
- auditing provisions to try and improve independence of auditors and spread audit work out rather than have this concentrated in the hands of a few auditors

- cost accounting requirements, seen as important tool to help control costs and promote efficiency in the corporate sector

From the 1980's onwards, the economy was liberalised. Initially a few liberalisation measures were introduced and then, in 1991, the socialist ideals, which included central planning, a controlled economy and tight regulation of foreign investment, were replaced by liberalisation and the opening up of the economy. This was reflected in the promulgation of the Companies (Amendment) Bill 1988 and the attempt to promulgate the Companies Bill 1997. Statutory legislation was still used to control the corporate sector and accounting regulation, but now the aims of the Companies Act were to facilitate liberalisation of the economy. Some decrease in the regulations to be followed by the corporate sector was proposed. However, the accounting provisions were, in fact, increased and greater control of accounting introduced through the proposal to set up a National Advisory Committee for Accounting Standards and some legal recognition for accounting standards in 1997. Thus, despite liberalisation, the use of statutory legislation to regulate accounting and the corporate sector continued and in the case of accounting, regulations were in fact increased rather than decreased. This is consistent with the culture of India in which strong regulation of the accounting system by statutory legislation is expected.

Statutory legislation and the professional accounting institutes

In addition to accounting being regulated by the Companies Act 1956, the use of statutory legislation is seen in the accounting profession in India. All three professional accounting institutes in India are set up using statutory legislation promulgated through the parliamentary system. The ICAI was set up in 1949 under the Chartered Accountants Act 1949 which included regulations on the functions and committees of the council of the ICAI, the disciplinary process of the ICAI and recognition of foreign qualifications. The ICWAI was set up under the Cost and Works Accountants Act 1959 and the ICSI was set up under the Company Secretaries Act 1980, which were similar to the Chartered

Accountants Act 1949. The parliamentary system is again seen to be an important influence on accounting change. Trans-system activity between the parliamentary system and the accounting profession in both the diffusion and reaction phases of the setting up of the ICAI and the setting up of the ICWAI is seen.

Statutory legislation and the tax audit and tax accounting standards

Statutory legislation was also important in the promulgation of the tax audit requirement and the promulgation of tax accounting standards by the CBDT. Both these changes to the accounting system were promulgated using the annual finance bill, due to concerns over tax collection, black marketeering and corruption.

Statutory legislation is a common means of regulation in India and is used to regulate many areas of social and economic life. For example statutory legislation was used to initiate social change and improve women's rights after independence and to regulate the economy, including licensing of the corporate sector, foreign exchange transactions and monopolies. The use of statutory legislation to promulgate accounting regulations is therefore consistent with the cultural and social context of India, in which strong statutory legislation of the economy is seen. The use of statutory legislation is, in fact, seen in all but one of the accounting changes analysed in this research.

Professional control of accounting

As well as statutory legislation, the cultural values of India indicate that professional control of accounting will also be seen and that there will be an active accounting profession in India. This is what is seen in practice. Within the accounting system in India, there are three professional accounting bodies, the ICAI, the ICWAI the ICSI. Of these, the ICAI and ICWAI are the most important for financial reporting, auditing and cost accounting.

The ICAI is the professional accounting institute that regulates financial reporting and auditing. The ICAI was set up in 1949, as discussed in chapter 10, to regulate the profession of chartered accountants. Before independence, the British Government set up a body, the IAB, to advise the Government on accounting and auditing issues and introduced the British ideal of an independent accounting profession in India. It was intended that the IAB would develop into an independent accounting body. However, the ICAI was not set up as an independent body but as a statutory body with Government involvement in the process for setting up the ICAI and with Government involvement in the running of the Institute. Thus the ICAI was set up in a way that was consistent with the cultural and social values of India.

The ICAI regulated financial reporting and auditing. Before 1977 the concerns of the profession were to train chartered accountants and to increase the profile and status of the accountancy profession. In 1977, the ICAI started to promulgate accounting standards to regulate financial reporting and in 1982 started to promulgate auditing standards. Until the 1990's, there was little interference by the Government in the standard setting process of the ICAI. Accounting standards were promulgated by the ICAI using a due process system, based on the due process systems of the ICAEW and the IASC, in which all parties interested in accounting participated. Initially the accounting standards promulgated using the due process system were recommendatory and most standards were made mandatory after some time. Most companies follow mandatory accounting standards in a uniform way and thus the ICAI has been an important regulatory institution in India. In the 1990's, the Government became directly involved in accounting standard setting. In 1996 the tax authorities became involved in the promulgation of tax accounting standards. In the Companies Bill 1997, the DCA proposed setting up their own body, the National Committee for Accounting Standards, to promulgate accounting standards, perhaps in response to the criticisms of the standard setting process of the ICAI, against the interests and wishes of the ICAI.

In addition to the ICAI, a separate institute for cost accounting was set up in India in the 1950's, adding to the professional regulation of accounting. As for

the setting up of the ICAI, the ICWAI was set up as a statutory body using legislation promulgated though the parliamentary system and with a council to run the institute, on which the Government was represented. The ICWAI was set up, with the involvement of the Government, in all phases of the change and set up for social and economic aims such as promoting equity between the different stakeholders in the corporate sector and to promote cost consciousness and economic efficiency in all enterprises in India, particularly the public sector , which was being developed. Once the ICWAI was set up as a statutory body, the cost accounting and cost auditing regulations in the Companies Act were promulgated, again to improve cost consciousness and efficiency in the economy.

Thus the ICWAI was set up in a way that fitted in with the cultural and social context of India, as was the ICAI, and in response to social, political and economic aims of the country. Both institutes created an active and important accounting profession in India. However, the accounting profession was not allowed to be fully independent by the Government who were actively involved in the process of setting up the institutes, setting up the institutes using statutory legislation and having representation on the councils that were set up to run the institutes.

The influence of the accounting profession on the Companies Act 1956

The accounting profession is also seen to be an important influence on all changes that relate to or affect accounting institutions and accounting regulations. In the changes to the Companies Act, discussed in chapters 6 to 9, intra-system activity is seen between the accounting profession and accounting regulation. The accounting institutes are seen to take an active role in the process of accounting change, arguing for changes that are in their interests and arguing against changes which are not in their interests. For example, the ICAI argued against the provisions of auditor rotation and successfully had these removed from the Companies (Amendment) Bill 1974. The ICAI was not always successful in influencing the provisions of the Companies Act 1956. For example, they were unable to prevent a ceiling being placed on the number of

audits any one auditor could perform in the Companies (Amendment) Bill 1974 and were not successful in stopping the promulgation of the provisions on the National Advisory Committee on Accounting Standards in the Companies Bill 1997.

The ICWAI was less involved in influencing the Companies Act 1956 until the 1990's as their interests were being supported by the Government. However, when the removal of the cost auditing requirements were being considered in 1997, they actively made representations to the Government to retain these requirements in the Companies Act as the removal of the cost accounting provisions would have reduced the role and status of the ICWAI and reduced the employment opportunity of cost accountants. The ICWAI were successful in their representations and the cost auditing requirements were not deleted in the Companies Bill 1997.

The ICSI also influenced accounting regulations in the Companies Act 1956 but, as for the ICWAI, were less involved than the ICAI since their interests were supported by the Government.

The representations made by all three accounting institutes were made within the parliamentary process i.e. in committees set up to review the Companies Act before the legislation was initiated in Parliament and to committees of the houses of parliament, which were set up to review the legislation. Representations were also made directly to the Government and its departments, for example the DCA, and to Members of Parliament, who would then be able to present the arguments of the accounting profession in committees and parliamentary debates on the legislation.

Alongside statutory regulation of accounting, professional regulation is expected in India. This indeed is what is seen, with three professional accounting bodies present in the accounting system, all of which influence accounting change, through intra-system activity in both the diffusion and reaction phase of accounting change. Professional regulation of accounting is seen with the ICAI regulating financial reporting and auditing and the ICWAI regulating cost

accounting. The accounting profession influences all accounting regulations and changes and is seen to become more proactive in accounting regulation with standard setting in the 1970's. However, statutory control and control by Government are seen to be more important and influential than the accounting profession.

Uniformity in the accounting system in India

The cultural values of India indicate that both uniformity and flexibility will be seen in the accounting system. However, from the surveys and interviews, it is seen that accounting regulations are applied in a very uniform manner and that there is little actual flexibility in the accounting system in India. Regulations, once promulgated, are generally followed by the corporate sector in India and companies follow accounting regulations in a very uniform way. All the companies surveyed follow the Companies Act and most companies followed mandatory accounting standards in a very uniform manner. In addition, uniformity is indicated in the interviews conducted with most of the parties interested in accounting in India.

Uniformity is also indicated in the analysis of accounting regulations which are not popular with the accounting profession. Statutory accounting regulations are followed once promulgated, even if against the interests and wishes of the accounting profession and the corporate sector. This is also indicated in the lack of a visible reaction phase seen in the promulgation of the Companies (Amendment) Bills 1974 and 1988 and the promulgation of tax accounting standards. Instead, informal interactions between the accounting profession, the corporate sector and the appropriate government authority are expected to take place to try and overturn these regulations which these parties are not happy with. In some cases, the accounting profession and the corporate sector have been successful as in the case of the promulgation of tax accounting standards by the CBDT and in others they have not been successful as in the setting up of the National Advisory Committee on Accounting Standards. This may also fit in

with the nation specific cultural value of family and caste based social system in which informal personal contacts and favours are common.

Secrecy and transparency in the accounting system in India

Some indications of secrecy and transparency are also obtained from the research in this thesis. As discussed in chapter 5, predictions based on the cultural values of India indicate that the accounting system will show a mixture of secrecy and transparency. However, from the data collected, predominantly the survey of company accounts and the interviews, the accounting values in India show a tendency to emphasise mainly secrecy with a little transparency. This may be due to the combination of cultural factors in India, which do not combine in a way which reinforce one set of accounting values but instead pull in different directions. In addition, the dominance of power distance and hierarchy in Indian society, as seen in the nation specific cultural values, suggest that secrecy will be more prevalent than transparency and this is what is seen in the accounting system of India. In the interviews conducted in India, most interviewees indicated that the financial reports of Indian companies show secrecy. In addition, the survey of company accounts for the year ending in 1996 and the survey of past company accounts showed that, generally, only disclosures required by law or mandatory accounting standards were given by companies. Some transparency is indicated with disclosures on social and environmental concerns, business reviews and research and development but as this information is not audited, it is argued that this does not increase the transparency of financial reporting significantly.

Indications of secrecy are also seen in the analysis of the standard setting process of the ICAI. Secrecy is seen in the standard setting process of the ICAI with representations made within the due process system used for promulgating accounting standards not being made public and being kept secret.

Conservatism and Optimism in the accounting system in India

Some indications of conservatism and optimism are also obtained from this research. As for the accounting values of secrecy and transparency, the predictions based on the cultural values of India indicate that the accounting system will show a mixture of conservatism and optimism. However, from the data collected, predominantly the survey of company accounts and the interviews, the accounting values in India show mainly conservatism with a little optimism.

This is seen in the interviews, with most interviewees indicating that the financial reports of Indian companies show conservatism. In addition, the survey of company accounts for the year ending in 1996 and the survey of past company accounts show that mainly conservative accounting practices are used.

Politics and accounting change in India

The process of accounting change is shown to be political in three main senses in this thesis i.e.

- by the involvement of Government in accounting
- by the promulgation of accounting regulations by the parliamentary system
- by the outcome of accounting change being affected by interactions and negotiations by all the parties interested in, and affected by, the accounting change

Involvement of Government in Accounting

The Government has been shown in the analysis of all the changes to be the most important influence on the accounting system and on the process of accounting change. This is in line, and consistent with, the cultural and social context of India. The cultural values of India indicate that Government will be involved in all social systems in India. This is reinforced by the social, political and economic aims of India after independence. At independence, the Government led by Nehru and Patel, introduced the aims of economic development together

with social justice and had a mandate for Government to be involved in all the initiatives and developments of the country. This was considered appropriate and the best means for running and developing the country.

The Government has been involved in all three phases of accounting change. The Government has been involved in initiating accounting change in the source phase, mainly for socio-economic reasons. Government has also been involved in the diffusion phase of all the changes, both in the process of change and with the accounting regulations increasing the involvement of Government in accounting. This applies to both the DCA and the taxation authorities. The Government has also been involved in the reaction phase, determining the final outcome of the change process.

Promulgation of Accounting Regulations by the Parliamentary System

Accounting is also seen to be political in the sense that the political system is used to promulgate accounting regulations, in all but one of the changes analysed in chapters 6 to 13. Statutory legislation is the main means of changing the accounting system. For example, accounting regulations are included in the Companies Act 1956 and changes to the Companies Act are all promulgated using the parliamentary system. Both the ICAI and ICWAI were set up under statutory legislation, the Chartered Accountants Act 1949 and the Cost and Works Accountants Act 1959 respectively, which again were promulgated using the parliamentary system. Statutory legislation too was involved in the regulations requiring tax audits and the setting of tax accounting standards. In these changes, the annual finance bill was used to promulgate the regulations affecting the accounting system.

Accounting Change as the Outcome of Interactions Between Parties Interested in Accounting

The process of accounting change is seen to be the outcome of interactions between the different parties interested in, and affected by, the accounting change. The main interactions are between the DCA, the professional accounting bodies, the corporate sector, the stock exchanges and the taxation

authorities and are analysed under intra-system activity and trans-system activity, in both the diffusion and reaction phases of the change. Where the parliamentary system is used to promulgate accounting regulations, the interactions take place within the parliamentary system, including within any committee set up to review the area of change, before legislation is drafted and introduced in Parliament. Within the parliamentary process, all parties interested in accounting are invited to give their views, both written representations to committees and giving oral evidence to the committees, when requested to do so. This is seen in all the changes to the Companies Act 1956.

The negotiation and lobbying process is also seen within the standard setting process of the ICAI. Accounting standards are promulgated using a due process system in which all parties interested in accounting change are involved. There is secrecy in the standard setting process and hence the lobbying process is not visible. However, the analysis of the standard setting process in chapter 11 indicates that the main parties are the corporate sector and the Government and standards are not promulgated or not made mandatory unless the support of these parties is anticipated by the ICAI.

A different set of parties is interested in each change and the most influential parties too are different in each change. However, in most of the changes the Government, either directly or indirectly, is important in influencing accounting change. Both formal and informal interactions between all parties interested in accounting and the Government take place to resolve contentious accounting issues and thus the Government plays an important role in the interactions between different parties which determines the outcome of the accounting change process. Formal interactions take place within the parliamentary process which includes committees set up to review legislation and debates on the legislation.

The Government also participates in the due process system used by the ICAI to promulgate accounting standards. It is expected that accounting standards which do not meet the approval of the Government would not be promulgated by the ICAI.

Informal interactions also take place between the Government and other parties interested in the change, such as the corporate sector and the accounting profession. These informal interactions are not easily visible and therefore hard to analyse but it is expected that the Government plays an important role in the negotiation over accounting change, within the interactions.

The accounting profession and the corporate sector too are involved in all of the accounting changes. The accounting profession is seen to be actively involved in all the accounting changes, trying to shape the changes in their own interests, sometimes successfully and sometimes not so successfully. For example, in the setting up of the ICAI, members of the IAB were keen to set up an independent accounting profession, which would increase the status of their profession. However, the ICAI that was set up was the result of interactions between the IAB, the Ministry of Commerce and Ministry of Finance and was set up as a statutory body in which there was Government involvement. In this change, formal interactions took place between the IAB and the Ministry of Commerce with the Ministry of Commerce delegating the task of reviewing the setting up of the ICAI to the IAB. Informal interactions between the IAB, the Ministry of Commerce and the Ministry of Finance in the diffusion phase were important in determining the outcome of the disciplinary process of the ICAI.

In the setting up of the ICWAI, interactions between the ICAI, the ICWAI and the Government were important in determining the outcome of the change. In the diffusion phase, the ICAI was very much against the setting up of the ICWAI and wanted cost accounting to remain as one of the functions of chartered accountants. However the Government perceived that cost accounting was important for the economic development of the country and felt it more appropriate that a separate institute devoted to cost accounting be set up, which fitted in with the wishes of the ICWAI. Interactions between the ICAI, ICWAI and the Government were also seen in the reaction phase with the issue of mutual recognition being determined by the outcome of interactions between these three parties. In this change, the Government and the ICWAI were seen to be more influential than the ICAI.

The promulgation of the regulations allowing the CBDT to promulgate tax accounting standards also indicates the political nature of accounting. In this change, interactions between the ICAI and the tax authorities within the Ministry of Finance determined the outcome of the change. The ICAI wanted standard setting to remain a function of the ICAI and did not want any other institutions to become involved in standard setting. In the diffusion phase of the change, they argued against standard setting by the tax authorities within the system but were not successful in stopping the CDBT gaining powers to promulgate tax accounting standards. In the reaction phase, the ICAI continued to informally interact with the tax authorities directly and an informal agreement was reached between the ICAI and the tax authorities, which limited the promulgation of tax accounting standards by the CBDT.

The accounting profession too was actively involved in the promulgation of the Companies Act 1956 and subsequent changes to the Companies Act. These interactions took place within the parliamentary system, both directly with the accounting profession making written submissions and giving oral evidence to committees within the parliamentary system and indirectly through informal interactions with the DCA, which administer the Companies Act. The accounting profession also lobbied members of parliament who could be persuaded to argue their case in the parliamentary debates on the changes to the Companies Act. All three accounting institutes were involved in these formal and informal interactions but the ICAI made the most representations and undertook most of the lobbying. The ICAI did have some success in the negotiating and lobbying process. For example they influenced the accounting provisions in the promulgation of the Companies Act 1956 and removing auditor rotation provisions in the Companies (Amendment) Bill 1974. The ICAI was not always successful. For example, restrictions on the number of audits any one auditor could undertake were introduced in the Companies (Amendment) Bill 1974 and the Companies Bill 1997 included a provision of the setting up of a National Advisory Committee for accounting standards. The ICWAI and ICSI were less involved in the lobbying and negotiation process as the Government included provisions, which coincided with the interests of the ICWAI and the ICSI.

The corporate sector too were involved in all the accounting changes as they were very much affected by the outcome of the accounting changes. The corporate sector made representations within the parliamentary system used to promulgate most of the accounting changes and interacted with the Government and the accounting profession, both directly and through trade associations such as Federation of Chambers of Commerce of India, Associated Chambers of Commerce of India and Confederation of Indian Industry. In the changes to the Companies Act in the 1950's, 1960's and 1970's, the corporate sector argued for the relaxation of regulations but were, on the whole, unsuccessful, in line with the increasing regulation of the whole economy. As the social, political and economic climate changed from central planning and control to liberalisation, the corporate sector became more influential in the process of accounting change and in influencing change in their interests, leading to a decrease in many regulations in the Companies Bill 1997.

The corporate sector was also influential in the due process system used by the ICAI to promulgate accounting standards. The views of the corporate sector would have been taken into account by the ICAI within the due process system. Accounting standards which the corporate sector did not find acceptable would either have been amended, not promulgated or not made mandatory. The ICAI have no effective mechanisms to enforce their accounting standards as the accounting standards are not legally enforceable. The ICAI therefore use a comprehensive due process system for promulgating accounting standards and enter into activities such as arranging seminars and workshops to persuade the corporate sector to follow accounting standards voluntarily.

The tax authorities too are significant influences on accounting change, although, not involved in all the changes. The CBDT and the tax authorities, were involved and influenced the setting up of the ICAI, influencing the disciplinary process of the ICAI and were also the main party in the tax audit requirements and the setting of tax accounting standards by the tax authorities.

Both formal and informal interactions between the different parties involved in the process of accounting change determine the outcome of the accounting

change. These interactions are affected by culture as is the process of accounting change itself. The interactions between different parties is seen in all the changes, in both the diffusion and reaction phases of the changes. In all the changes the main parties involved in the changes are institutions within the accounting system, the DCA, the ICAI, the ICWAI and the ICSI and systems and institutions neighbouring the accounting system, the legal system, the parliamentary system, the corporate sector, the stock exchanges, SEBI and the international system.

From the above, it can be seen that the process of accounting change is significantly influenced by culture and politics and the theoretical framework proposed in the thesis is useful in analysing the influence of culture and politics on accounting change. Thus, the exploratory research in this thesis provides some useful insights into the linkages between culture, politics and accounting. However, further research is needed and this is outlined below.

Further Research

The research in this thesis provides an exploratory historical study of accounting change in India and analyses the main changes to accounting institutions and accounting regulation in India. Research on accounting in India needs further development. The theoretical framework needs to be applied to other changes to the accounting system in India which have not been addressed in this thesis. For example, the analysis of changes to auditing regulations, the public sector and small and medium enterprises are needed as these are important areas in India but have been outside the scope of this thesis.

Analyses of changes to specific regulations are also needed to gain more insights into the accounting values seen in the accounting system in India. Further research would provide more information on the influence of culture and politics on accounting change in India, as more changes are analysed. In this further research, the data sources could be extended. For example, the number of

interviews could be extended and a larger number of company accounts could be surveyed including companies which started business after the 1950's.

In addition, the specific issue of international accounting harmonisation needs to be analysed in India. The issue of using one set of accounting standards, for example international accounting standards as promulgated by the IASC, in countries with different cultural, economic and political contexts in different countries needs to be addressed in more detail. International accounting standards may still be valid in countries with different backgrounds and different cultural, economic and political contexts may not preclude harmonisation using one set of accounting standards. But detailed studies of this issue in different countries are needed.

Finally, historical studies of accounting change, using the theoretical framework applied here, in other developing countries are needed, to see if the framework has wider applicability. Both analyses of countries in Asia with similar British colonial histories to India and countries with different histories to India are required to gain further insights into the process of accounting change in different cultural and political contexts. The research programme could also be extended to developing countries in Africa and South America. Comparisons with accounting change in the developed countries too would provide useful insights into the process of accounting change and the international harmonisation of accounting.

Appendix 1

Accounts of companies for the year ending in 1996

	Company	Date Company Started
1	Ahmedabad Electricity Company Ltd	1913
2	Alfa Laval (India) Ltd	1937
3	Andhra Valley Power Supply Company Ltd	1916
4	Asea Brown Boveri Ltd	1949
5	Ashok Leyland Ltd	1958
6	Asian Paints (India) Ltd	1945
7	Associated Cement Company Ltd	1936
8	Bajaj Auto Ltd	1945
9	Bajaj Tempo Ltd	1958
10	Ballarpur Industries Ltd	1945
11	BASF Ltd	1943
12	Bata India Ltd	1931
13	Bayer Ltd	1958
14	Bharat Petroleum Corporation Ltd	1952
15	Birla Jute and Industries Ltd	1919
16	BOC India Ltd	1935
17	Bombay Burmah Trading Corporation Ltd	1863
18	Bombay Dyeing and MFG Company Ltd	1879
19	Boots Pharmaceuticals Ltd	1944
20	Britannia Industries Ltd	1918
21	Brooke Bond Lipton India Ltd	1912
22	BSES Ltd	1929
23	Cadbury India Ltd	1948
24	Ceat Ltd	1958
25	Century Textiles & Industries	1897
26	CESC Ltd	1897
27	Cipla Ltd	1935
28	Colgate Palmolive (India) Ltd	1937
29	Colour Chem Ltd	1956
30	Crompton Greaves Ltd	1947
31	Cyanamid India Ltd	1947
32	East India Hotels Ltd	1949
33	Escorts Ltd	1944
34	Forbes Gokak Ltd	1919
35	Garware Polyester Ltd	1957
36	GEC Alsthom India Ltd	1957
37	Glaxo India Ltd	1924
38	Grasim Industries Ltd	1947
39	Great Eastern Shipping Company Ltd	1948
40	Hindalco Industries Ltd	1958
41	Hindusthan Ciba Geigy Ltd	1947
42	Hindusthan Development Corporation Ltd	1944

43	Hindusthan Lever Ltd	1933
44	Hindusthan Motors Ltd	1942
45	Hoescht India Ltd	1956
46	ICI India Ltd	1954
47	India Cement Ltd	1947
48	Indian Aluminium Company Ltd	1938
49	Indian Rayon Ltd	1956
50	Ingersoll Rand (India) Ltd	1921
51	IPCA Laboratories Ltd	1949
52	ITC Ltd	1910
53	JCT Ltd	1946
54	JK Corporation Ltd	1938
55	JK Industries Ltd	1951
56	KEC International Ltd	1945
57	Kesoram Industries Ltd	1919
58	Larsen and Toubro Ltd	1946
59	Madras Cement Ltd	1957
60	Mahindra and Mahindra Ltd	1945
61	Morarjee Goculdas Spg & Wvg Company Ltd	1871
62	Motor Industries Company Ltd	1951
63	Mukand Ltd	1937
64	Nestle India Ltd	1959
65	Nicolas Piramal Ltd	1947
66	Orient Paper & Industries Ltd	1936
67	Otis Elevator (India) Ltd	1953
68	Parke Davis (India) Ltd	1958
69	Pfizer Ltd	1950
70	Philips India Ltd	1930
71	Rallis India Ltd	1948
72	Raymond Ltd	1925
73	Reckitt and Colman India Ltd	1951
74	Sandoz Ltd	1947
75	Siemens Ltd	1957
76	SIV Industries Ltd	1957
77	Smithkline Beecham Consumer Healthcare Ltd	1958
78	Special steels Ltd	1958
79	State Bank of India	1955
80	Supreme Industries Ltd	1942
81	Tata Chemicals Ltd	1939
82	Tata Engineering and Locomotive Company Ltd	1945
83	Tata Hydro-Electric Power Supply Company Ltd	1910
84	Tata Iron and Steel Company Ltd	1907
85	Tata Power Company Ltd	1919
86	Tube Investments of India Ltd	1949
87	Voltas Ltd	1954
88	VST Industries Ltd	1930
89	Wipro Ltd	1945

Appendix 2

Survey questions

1 Formats and disclosure of accounting policies

1.1 Regulated by Co Act

a -are standard formats for balance sheet followed- vertical or horizontal
b -are any items affected by a change in the basis of accounting disclosed if material

1.2 Regulation by accounting standards

As 1 - Disclosure of accounting policies - mandatory for all periods commencing on or after 1.4.1991

a are all significant accounting policies disclosed in clear and concise manner and in one place
b are disclosures made of accounts that do not follow the fundamental accounting assumptions of going concern, accruals and consistency
c are changes in significant accounting policies disclosed
d is the effect of any change quantified
e are reasons for changes in accounting policies given

2 Reserves and surplus

2.1 Regulated by Co Act

a -are the different types of reserves disclosed (ex capital redemption reserve, share premium)
b -is the profit and loss account surplus disclosed
c -are additions to reserves and withdrawals from reserves disclosed

2.2 No regulation by accounting standards

2.3 Are there any voluntary disclosures on reserves and surplus

2.4 Regulated by Stock exchange

a -are debenture redemption reserves maintained
b -are disclosures of changes to the debenture redemption reserve made

3 Fixed assets and depreciation

3.1 Regulated by Co Act

a -are fixed assets split into goodwill, land, buildings, leasehold, railway sidings, plant and machinery, furniture and fittings, development of property, patents, trade marks and designs, livestock and vehicles
b -are disclosures on additions and disposals to fixed assets made
c -are disclosures on additions and disposals to depreciation made
d -is the total depreciation written off in the period disclosed
e -are rates of depreciation as specified in the Co Act used
f -if rates not specified in the Co Act are used, is this disclosed
g -if assets are revalued or written down - are disclosures made of this for 5 years

3.2 Regulated by Accounting standards

(i) AS 10 - Accounting for fixed assets - mandatory for periods commencing on or after 1.4.1991

a -are the gross and net book values of fixed assets disclosed
b -is expenditure incurred on account of fixed assets in the course of construction disclosed - is the method adopted to compute revalued amounts, the nature of indices used for revaluations if appropriate, the year of any revaluation appraisal and whether an external valuer was involved in the revaluation disclosed
c -are revaluations credited to a revaluation reserve

(ii) AS 6 - Depreciation accounting - recommendatory

a -is the method of accounting for depreciation disclosed
b -is the historic cost (or revalued amount), total depreciation for the period and accumulated depreciation disclosed for each category of asset
c -are depreciation rates disclosed if different from government required depreciation rates
d -if depreciation rates are changed - is depreciation recalculated and any change put through in year of change with suitable disclosures
e -is depreciation on revalued assets disclosed if materially different from before revaluation
f -is the gain or loss on disposals of depreciable fixed assets disclosed

4 Investments

4.1 Regulated by Co Act

a -is disclosure made of the policy including method of valuation on long-term investments
b -are investments broken down into quoted and unquoted, government securities, shares, debentures or bonds, immovable properties, investment in the capital of partnership firms
c -are the bodies corporate in which investments have been made identified
d -is the market value of quoted securities disclosed

e -is investment income, other income, profits or losses on investments disclosed

Investments - Regulated by accounting standards

4.2 AS 13 - Accounting for investments - comes into effect for financial statements covering periods commencing on or 1.4.1995 *(to check whether recommendatory or mandatory)*

a -is the accounting policy for determining the carrying amount of investments disclosed
b -are investments split into long term and short term (current) investments
c -are investments (both long term and current) carried at lower of cost or fair value
d - are both short term and long term investments split into government or trust securities, shares, debentures and bonds, investment properties and others
e - is the aggregate amount of quoted and unquoted investments disclosed
f -are reductions in the value of both long term and current investments recorded in the profit and loss account
g -on disposal is the difference between disposal proceeds and carrying value of the investment (profit or loss) recorded in the profit and loss account for all investments
h -are transfers between long term investments and current investments made at the lower of cost or market value on date of transfer
i -are differences between the carrying amount of investments and their value disclosed
j -are disclosures made of any significant restrictions on the rights on ownership, realisability of investment and remittance of income
k -are separate disclosures made of income from investments (dividends, interest, royalties) in the profit and loss account

5 Inventory

5.1 Regulated by Co Act

a -is the policy on inventory valuation disclosed
b -is inventory split into stores and spare parts, loose tools, stock in trade, work in progress
c -is purchases, opening and closing stocks and raw materials consumed, disclosed in detail
d -are disclosures made of indigenous vrs importer raw material purchases/ inventory

5.2 Regulated by accounting standards

AS 2 - Valuations of inventories - recommendatory

a -are inventories recorded at lower of cost and net realisable value
b -are inventories split into raw materials and components, work in progress, finished goods and stores and spares
c -is the measurement basis for recording inventory disclosed
d -what basis are used to value inventory - FIFO, average cost or some other basis
e -if the accounting policy is changed, are disclosures made of the effect of the change on the financial statements

6 Contingent liabilities

6.1 Regulated by Co Act

a -are contingent liabilities provided for disclosed
b -are contingent liabilities not provided for disclosed and quantified

6.2 Regulated by accounting standards -

AS 4 - Contingencies and events occurring after the balance sheet date - mandatory for all periods commencing on or after 1.4.1995

a -are contingent liabilities accounted for using AS 5
* i.e. account for contingent loss when it is likely that the loss will arise and only account for contingent gains if it is virtually certain that the gain will be realised
b -are disclosures made of the uncertainties surrounding all contingent liabilities
c -is the financial effect of the contingent liabilities disclosed
d -are accounts changed for post balance sheet events which give further evidence of conditions existing at the balance sheet date
e -are disclosures made of the nature and financial effect (if possible) of both adjusting and non adjusting post balance sheet events that materially affect the financial position of the enterprise

7 Revenue recognition

7.1 No regulation by Co Act

7.2 Regulated by Accounting standards

AS 9 - Revenue recognition - mandatory for all periods commencing on or after 1.4.1991

a -are transactions covering sale of goods, rendering of services, interest, dividends and royalties accounted for using AS 9 i.e.
*sale of goods - when sale complete and title transferred to buyer, rendering of services - either under completed service contract method or proportionate completion method, interest or rent - time basis, royalties - as per agreement and dividends - when owners right to dividends accrues
b -is disclosure of the accounting policy relating to revenue recognition made

8 Prior period / extraordinary/ exceptional items

8.1 Regulated by Co Act

a -are disclosures of any transactions that are exceptional made

b -are profits or losses on transactions of exceptional or non recurring nature disclosed

8.2 Prior period, extraordinary, exceptional items - Regulated by accounting standards

AS 5 - Prior period and extraordinary items and changes in accounting polices - mandatory for periods commencing on or after 1.4.1987

a -are prior period items shown separately in the profit and loss account
b -is the nature and amount of each prior period item disclosed separately
c -are extraordinary items included as part of net income
d -is the nature and amount of each extraordinary item disclosed separately
e -are disclosures made of reasons for changes in policy and of the financial effect on the current results
f -are disclosures made of the future financial effect of accounting policy changes
g -are exceptional items disclosed separately

9 Taxes

9.1 Regulated by Co Act

a -are disclosures of income tax, other Indian taxes on income and other rates and taxes made
b -is the amount charged for income tax and other taxes on profit disclosed
c -are disclosure of taxes in dispute made

9.2 No regulation by accounting standards

9.3 Voluntary

a -is deferred tax provided for
b -are disclosures of the deferred tax accounting policy made
c -is the basis of providing for deferred taxes disclosed - if so what is the basis used

10 Pension costs / Retirement benefits

10.1 Regulated by Co Act

a -are disclosures of contribution to staff provident fund schemes made
b -are disclosures made of pensions, gratuities, payments from provident funds, compensation for loss of office and any consideration in connection with retirement from office given to directors

10.2 Pension costs, retirement benefits - Regulated by Accounting standards

AS 15 - Accounting for retirement benefits in the financial statements of employers - mandatory for all periods commencing on or after 1.4.1995

a -is the policy on pensions disclosed

b - are disclosures of the method by which retirement benefits costs for the period have been determined made i.e.

*if the scheme is a provident fund or defined contribution scheme has the amount payable by the employer been charged to the profit and loss account.

*if the scheme is a gratuity or defined benefit scheme (whether the employer has chosen to make payments, the liability for retirement benefits is funded through a trust or the retirement benefit is funded through a scheme administered by an insurer), has an appropriate charge been made to the profit and loss account calculated on the basis of an actuarial valuation.

* For both types of schemes, have any amounts not paid been treated as a accrual in the balance and any payments paid in excess of amount payable treated as a prepayment in the balance sheet

c -where actuarial valuations are given is it stated whether the actuarial valuation is at the end of the period or at an earlier date - if at an earlier date is the date of actuarial valuation given

10.3 Voluntary

a -are past service costs/experience adjustments made and disclosed

11 Government grants

11.1 No regulation by Co Act

11.2 Regulated by accounting standards

AS 12 - Accounting for Government grants - mandatory from all periods starting on or after 1.4.1994

a -is the policy on government grants given including the method of presentation in the financial statements disclosed

b -are government grants accounted for as per AS 12 as follows

* if for fixed assets, is the grant deducted from fixed assets or treated as deferred income

*if for revenue expenses, is the grant recognised on a systematic basis in the profit and loss account to match the costs towards which the grant has been given

*if towards promoters contribution, is the grant credited to capital reserve and treated as shareholders reserve

c -are government grants that become refundable treated as an extraordinary item

12 The Audit report

12.1 Regulated by the Co Act

a -are auditors reporting on the following - whether secured loans and advances made by the company are properly secured and are on terms which are prejudicial to the company or members, whether transactions which are just book entries are prejudicial to the interests of the company, whether personal expenses have been charged to the revenue account and whether cash from allotment of shares has actually been received

b -Does the audit report positively confirm whether the auditor has obtained all information and explanations required, whether proper books of account have been kept, whether proper returns from branches not visited have been received and whether the profit and loss account and the balance sheet agree with the books of account

c -have the auditors undertaken a cost audit and reported on the requirements

d -has a tax audit taken place taken place if necessary

e -have payments to auditors as auditor, for taxation, company law and management services work been disclosed

13 Cash flow statement

13.1 No regulation by Co Act

13.2 No regulation by accounting standards

13.3 are there any voluntary disclosures by Co

13.4 Regulated by stock exchange

a -is a cash flow statement provided

b -is the standard format required by the stock exchange used

c -is the cash flow statement certified by the auditors

14 Statement of source and application of funds

14.1 No regulation by Co Act

14.2 Regulated by accounting standards

AS 3 -Changes in financial position - recommendatory

a -is a statement of source and application of funds prepared

b -does the information in statement identify with items in the bs and p+l

c -are the funds from operating activities shown separately

d -are unusual items shown separately in the statement

e -are changes in individual components of net working capital shown separately

15 Strategic Information- General corporate information

15.1 Regulated by Co Act

a -is the general business profile and company data given

15.2 No regulation by accounting standards

15.3 voluntary

a -is a brief history of the company given
b -is a current year financial highlights statement given
c -are details of the organisational structure given

16 Strategic Information - Corporate strategy

16.1 Regulated by the Co Act (required in directors report

a -is a review of key business changes over the financial year given
b -is quantitative information on licensed capacities, installed capacities and actual production given

16.2 No regulation by accounting standards

16.3 voluntary

a -is a statement of general strategy and objectives given
b -is a statement of financial strategy and objectives given
c -is a statement of marketing strategy and objectives given
d -is a statement of social strategy and objectives
e -is the impact of strategy on current results given
f -is the likely impact of strategy on future results given

17 Strategic Information - Acquisitions, amalgamations and disposals

17.1 Regulated by Co Act

a -is a statement of the company's interest in its subsidiary given
b -are the subsidiaries' accounts attached to the accounts of the holding company
c -where accounts of subsidiaries do not coincide with holding company's accounts, are disclosures made of any material changes in the holding company's interest and any major changes in fixed assets, investments debtors and creditors in the subsidiary between the end of the holding company's financial year and the end of the subsidiaries financial year
d -are dividends paid and proposed from subsidiary companies disclosed
e - are provisions for losses of subsidiary companies made

17.2 Acquisitions. amalgamations and disposals - Regulated by accounting standards

AS 14 - Accounting for amalgamations (mergers and take-overs)- mandatory from periods starting on or after 1.4.1995

a - are mergers accounted for using the pooling of interests method and all other amalgamations using the purchase method
b -are the names and general nature of business of the amalgamating parties given
c -is the effective date of amalgamation given
d is the method of accounting for the amalgamation disclosed
e -is the number of shares and percentage of each company's equity shares exchanged disclosed
f -is the difference between the consideration and the value of the net identifiable assets in the pooling on interests method given
g - is the consideration paid including details of any contingent consideration payable disclosed if the purchase method is used
h -is the goodwill disclosed in the purchase method
i -is the accounting treatment and amortisation period of goodwill disclosed

17.3 voluntary

a -are details of the company's holding company given if it has a holding company
b -are reasons for acquisitions given
c -are the qualitative effects of acquisition on results of current period given
d -are the reasons for disposals given
e -is the amount of consideration realised from disposals given
f -are the qualitative effects of disposals on the results of the current period given
g -what is the accounting for treatment for associates
h -is the accounting policy for associates given
i - is the accounting policy for joint ventures given
j -what is the accounting treatment for joint ventures

18 Strategic Information - Research and development, technology absorption, innovation and conservation of energy

18.1 Regulated by Co Act - as annexure to the directors report

a -is a description of research and development projects given
b -are benefits derived as a result of R+D projects given
c -is a future plan of action for R+D given
d -are efforts made towards technology absorption, adaptation and innovation disclosed
e -are benefits derived as a result of the above given
f -are disclosures on conservation of energy (power and fuel consumption made

18.2 R+D etc - Regulated by accounting standards

AS 8 - Accounting for R+D -mandatory for all periods commencing on or after 1.4.1991

a -are R+D costs accounted as per AS 8 - written off or deferred to future periods if appropriate
b -is the total R+D costs both the amortised portion of deferred costs and expenses disclosed
c is the amortisation period for capitalised R+D disclosed
d -is deferred R+D expenditure disclosed in the balance sheet under "misc. expenditure"

18.3 voluntary

a -is the number employed in research and development given
b -is the location of research and development activities given

19 Strategic Information - Future Prospects

19.1 Regulated by Co Act

a -is expenditure committed for capital projects but not provided for disclosed

19.2 No regulation by accounting standards

19.3 Voluntary

a -is a qualitative statement of future prospects given
b -is a qualitative forecast of sales given
c -is a quantitative forecast of sales given
d -is a qualitative forecast of profits given
e -is a quantitative forecast of profits given
f -is a qualitative forecast of cash flows given
g -is a quantitative forecast of cash flows given
h -are the assumptions underlying the forecasts given

20 Non financial Information - Directors and higher paid employees

20.1 Regulated by Co Act

a -are disclosures of whether higher paid employees are relatives of a director or manager made
b -is the age, designation, nature of duties, date of commencement of employment, qualification, experience, gross remuneration, last employment designation disclosed in the directors report
c -are directors' interests or higher paid employees' interests in company contracts, loans and loan guarantees disclosed
d -is remuneration, allowances, commission, perquisites, benefits in kind, pensions to directors including calculation of commission payable to directors based on Co act disclosed

20.2 Directors and higher paid employees - No regulation by accounting standards

20.3 voluntary

a -are non executive directors disclosed/ identified
b -is the commercial expertise and experience of non executive directors given
c -are other directorships held by executive directors disclosed
d -are other directorships held by non executive directors disclosed
e -are shareholdings by directors in the company given

21 Non Financial Information - Employees

21.1 Regulated by Co Act

a - is the expenditure on salaries, wages, bonuses, contribution to provident fund and workmen and staff welfare expenses disclosed

21.2 No regulation by accounting standards

21.3 Non Financial Information - Employees - voluntary

a -is the geographical distribution of employees given
b -is the line of business distribution of employees given
c -are categories of employees by gender given
d -are categories of employees by function given
e -is the number of employees working for two or more years given
f -are reasons for changes in employee numbers or categories given
g -are there any share option schemes for employees. If so is the policy for such schemes given
h -are there any profit sharing schemes for employees and if so is the policy for profit sharing schemes given
i -is the policy on training given
j -is the amount spent on training disclosed
k -is the nature of training disclosed
l -are the categories of employees trained given
m -are the number of employees trained given
n -is general welfare information given
o -is the safety policy given
p -is any data on accidents given
q -is the cost of safety measures given
r -is the policy on communication given
s -is general redundancy information given
t -is an equal opportunities policy statement given
u -is information on recruitment problems and related policy given
v - is a statement of thanks to employees given
w -is a statement on employee relations given

22 Non financial information - social policy, environmental and value added information

22.1 No regulation by Co Act

22.2 No regulation by accounting standards

22.3 voluntary

a -is the general safety of products disclosed
b -are general charitable donations disclosed
c -are general community programs disclosed
d -is a value added statement given
e -is value added data given
f -are value added ratios given
g -is qualitative value added information given
h -is qualitative information on environmental protection programs given
i -is quantitative information on environmental protection programs given

23 Financial Information - segmental information

23.1 Regulated by Co Act

a -is aggregate turnover analysed by class of business

23.2 No regulation by accounting standards

23.3 voluntary

a -is quantitative geographical profit information given
b -is quantitative geographical capital expenditure information given
c -is quantitative geographical net assets information given
d -is qualitative geographical production information given
e -is quantitative geographical production information given
f -is quantitative line of business profit information given
g -is quantitative line of business capital expenditure information given
h -is quantitative line of business net assets information given
i -is quantitative line of business production information given
j -is qualitative competitor analysis information given
k -is quantitative competitor analysis information given
l -is qualitative market share analysis information given
m -is quantitative market share analysis information given

24 Financial information - financial review

24.1 No regulation by Co Act

24.2 No regulation by accounting standards

24.3 Financial information - financial review - Voluntary

a -are profitability ratios given
b -are qualitative comments on profitability given
c -are cash flow ratios given
d -are liquidity ratios given
e -are gearing ratios given
f -are brand valuations disclosed
g -are other intangible valuations (except goodwill) disclosed
h -is the dividend payout policy given
i -is the transfer pricing policy given
j -is the impact of any accounting policy changes on results given
k -is the financial history or summary - three or more years given
l -is the financial history or summary - six or more years given
m -is financial information restated to follow US or UK regulations
n -is financial information restated to follow other non Indian regulations
o -is financial information restated to follow IAS
p -is qualitative off balance sheet financing information given
q -is qualitative advertising information given
r -is quantitative advertising information given
s -are the qualitative effects of inflation on future operations given
t -are the qualitative effects of inflation on results given
u -are the effects of inflation on results quantified
v - are qualitative effects of inflation on assets given
w - are the effects of inflation on assets quantified
x -are the effects of interest rates on current results given
y -are the effects of inflation on future operations given

25 Financial Information -Foreign currency information

25.1 Regulated by Co Act

a -is a statement of foreign exchange earnings and outgo included in the directors report
b -are earnings in foreign exchange under export of goods, royalty, know how, professional and consultation fees, interest and dividend and other income disclosed
c -is the value of imports in respect of raw materials, components and capital goods disclosed
d -is expenditure in foreign currency on royalty, know how, professional and consultation fees, interest and other disclosed
e -is the amount remitted during the year in foreign currencies on dividends with disclosure of number of non resident shareholders disclosed

25.2 Financial Information - Foreign currency information - Regulated by accounting standards

AS 11 - Accounting for the effects of changes in foreign exchange rates- - mandatory for all periods commencing on or after 1.4.1995

a -are transactions in a foreign currency accounted for using AS 11 i.e.
*are transactions translated at date of transaction
*are monetary items (except fixed assets) retranslated at the closing rate at the balance sheet date
*are non monetary items valued at historic cost (except fixed assets) reported using the exchange rate at the date of transaction
*are foreign exchange liabilities incurred for the purpose of acquiring fixed assets retranslated at the balance sheet closing rate and the fixed assets also adjusted to take into account any increase or decrease in the liability of the enterprise due to exchange differences

b -are foreign branches accounted for using AS 11
* i.e. revenue items translated at average rate, opening and closing inventories translated at rates prevailing at start and end of financial year respectively, depreciation translated at same rate as the fixed assets to which they relate, monetary items translated at balance sheet closing rate, non monetary items except fixed assets and inventories translated at the exchange rate at the date of transaction and fixed assets translated at date of transaction (acquisition date or revaluation date). If fixed assets are acquired by loan in foreign currency, are the fixed assets adjusted for any changes in the liability due to exchange differences.
* are the net exchange differences recognised in the profit and loss account for the period.

c -are exchange differences arising on foreign currency transaction recognised in the profit and loss account in the period in which they arise

d -is the amount of exchange differences included in the profit or loss for the period disclosed

e -is the amount of exchange differences adjusted in the carrying amount of fixed assets disclosed

f -is the enterprises foreign currency risk management policy disclosed (this is encouraged by the standard)

25.3 Voluntary

a -are the qualitative effects of foreign currency fluctuations on future operation disclosed

b -are the qualitative effects of foreign currency fluctuations on current results disclosed

c -are the quantitative effects of foreign currency fluctuations on current results disclosed

d -are the major exchange rates used in the accounts disclosed

e -is long term debt by currency disclosed

f -is short term debt by currency disclosed

g -is there a description of foreign exchange exposure management techniques

26 Financial Information - Stock Price information

26.1 No regulation by Co Act

26.2 No regulation by accounting standards

26.3 voluntary

a -is the share price at the financial year end given
b -is share price trend information given
c -is the market capitalisation at the financial year end given
d -is market capitalisation trend information given
e -is the size of shareholdings given
f -are the types of shareholder given
g -is information on significant shareholders given
h -is foreign stock market listing information given

Appendix 3

Survey from 1970 to 1996

Multinationals

Ingersoll Rand - year ended 1977, 1980, 1985, 1989
Glaxo- year ended 1970, 1975, 1980, 1985, 1990
Hindusthan Lever - year ended 1976, 1980, 1985, 1990

Indian Owned Companies

Mahindra and Mahindra - year ended 1970, 1975, 1980, 1985, 1990
CEAT - year ended 1976, 1980, 1985, 1990
Hindalco - year ended 1975, 1980, 1985, 1990
Tata Iron and Steel Company - year ended 1971, 1975, 1980, 1985
Tata Hydro- year ended 1973, 1975, 1980,1985
Tata Chem - year ended 1970, 1985, 1980, 1985

Survey from 1947 to 1996

Multinationals

Colour Chem - year ended 1959, 1960, 1965, 1970, 1975, 1980, 1985, 1990
Philips - year ended 1957, 1960, 1965, 1971, 1975, 1980, 1985,1990

Indian Owned

Bombay Burmah Trading Corporation - year ended 1940, 1956, 1960, 1965, 1970, 1975, 1980, 1985, 1990
Grasim - year ended 1954, 1960, 1965, 1970, 1975, 1980, 1985, 1990
Tata engineering and locomotive company - year ended 1946, 1950, 1956, 1960, 1975, 1980, 1985

Multinational taken over by the Government in 1970's

Burmah shell taken over and renamed as Bharat Petroleum in 1974

Burmah Shell - year ended 1957, 1960, 1966, 1970
Bharat Petroleum - year ended 1975, 1980, 1985, 1990

Appendix 4

Parliamentary reports and debates reviewed

Chapter 6 - Companies Act 1956

Companies Act 1956
Report of the Company Law Committee (known as the Bhahbha report), 1952
Companies Bill 1953
Report of the parliamentary committee on the Companies Bill 1953, 1953
Parliamentary debates on the Companies Bill 1953
Report of the Company Law Amendment Committee (known as the Shastri report), 1957

Chapter 7 - Companies (Amendment) Bill 1974

Companies Bill 1973-1974
Report of the parliamentary committee on the Companies Bill 1974, 1974
Parliamentary debates on the Companies Bill 1974
Notification

Chapter 8 - Companies (Amendment) Bill 1988

Companies Bill 1987-1988
Report of the Expert Committee on the Companies and MRTP Acts (known as the Sachar Committee report), 1978
Parliamentary debates on the Companies Bill 1988

Chapter 9 - Companies Bill 1997

Report of the Working Group on the Companies Bill 1956, 1997
Companies Bill 1997
Companies (Amendment) Ordinance, 1998

Chapter 10 – The setting up of the Institute of Chartered Accountants

Report of the parliamentary committee on the Chartered Accountants Bill, 1948
Parliamentary debates on the Chartered Accountants Bill 1949

Chapter 12 – The setting up of the Institute of Cost and Works Accountants and cost accounting and cost auditing in India

Companies Act 1956
Report of the parliamentary committee on the Cost and Works Accountants, Bill, 1958
Parliamentary debates on the Cost and Works Accountants Bill 1959

Appendix 5

General questions

A 1 What are the most important forms of accounting regulation?

Has there been any change in the relative importance of these regulations since independence?

A 2 Are there any conflicts between the different forms of regulation?

A 3 Is there any flexibility regarding which regulations companies follow?

A 4 Are there any other regulations that companies have to follow?

A 5 What is the involvement of the government in setting and enforcing accounting regulations?

A 6 When accounting regulations are set in India, are the following taken into account:

a international accounting standards
b accounting developments in other countries for example the United Kingdom and the United States
c international bodies and regional bodies such as the United Nations, OECD and the European Union.

A 7 Have there been any other international influences on accounting and auditing in India for example by international accounting firms?

A 8 What are the ways that companies can influence the following accounting regulations:

- the Companies Act
- accounting standards issued by the Institute of Chartered Accountants of India
- accounting regulations issued by SEBI and the stock exchanges
- accounting regulations issued by the tax authorities

A 9 Have there been any changes in accounting regulations after liberalisation? Do you think that changes are needed to the accounting system after liberalisation?

A 10 What are the main sources of finance for companies and has this changed since independence? Are financial institutions and / or the government represented on the board of directors of companies?

A 11 What are the aims and objectives of financial reporting in India? For example are accounts prepared:

- for creditor protection
- for shareholder information
- for accountability to the general public
- for corporate governance
- to encourage companies to undertake policies that fulfil the country's economic objectives

- to encourage companies to undertake polices that fulfil the country's social objectives

A 12 Has there been any change in the aims and objectives of accounting in India since independence?

In particular has there been a connection between the social and economic conditions of India and the accounting regulations that have been promulgated?

A 13 Indian companies make some voluntary disclosures that are not made by British Companies for example employee relations statements, social and community involvement disclosures and details of business collaborations. In addition the chairman's statement covers many comments about the economy, government policy and social information.

Why are companies making these disclosures and who are the disclosures aimed at?

What are the benefits and costs that are perceived to arise from making these disclosures?

A 14 Some companies make voluntary disclosures of areas which are later regulated by the Companies Act, for example research and development, foreign exchange and energy conservation. These appear to be areas that are also important for the economic development of the country and hence areas which the government would like to encourage.

In this way, is accounting being used by the government as one means of encouraging companies to follow government desired policies and practices, both for the economic and social development of the country?

A 15 Do companies use their accounts to show their support for the government and how they contribute towards government policies. Do Companies also use their accounts to comment on inappropriate government policies?

A 16 In your opinion, which of the following accounting characteristics are seen in the Indian accounting system:

a professionalism or statutory control as the authority for the preparation of financial statements by companies
b uniformity or flexibility in how regulations are applied by companies
c conservatism or optimism in measurement practices
d secrecy or transparency in disclosure practices

Please give reasons for your answer.

Change 1 - The Companies Act 1956

Promulgation of the Companies Act in 1956

B 1 What were the main forms of accounting regulation extant at independence?
What were the opportunities for Indian accountants before independence?

B 2 Who initiated the promulgation of the Companies Act 1956 and why?
What was the background to the promulgation of the Companies Act 1956?

B 3 Why was the Companies Act chosen as the main method of regulating companies?

B 4 The Companies Act was very much based on the British model for example introducing the requirement for accounts to show a true and fair view but with a few differences such as:

- specified standard formats for the balance sheet
- specified contents for the profit and loss account though no standard format was specified
- extended audit requirements
- the government retaining the power to modify or adapt any of the requirements of the Companies Act

What were the reasons for following the British model?

What were the reasons for the above provisions in the Companies Act 1956?

B 5 What was the process for promulgating the Companies Act 1956?
Which government bodies and departments were responsible for the promulgation of the Companies Act 1956?

B 6 What is the background and role of the Department of Company Affairs and the Company Law board?

B 7 Who was consulted about the provisions of the Companies Act 1956 and who influenced the Companies Act 1956?

B 8 Once the Companies Act was promulgated, what was the reaction to the Act?

Major changes to the Companies Act 1956 in 1973, 1974 and 1988 and the Sachar committee report.

B 9 Who initiated the 1973, 1974 and 1988 amendments to the Companies Act 1956?
What was the background to the amendments and why were they required?

B 10 What was the procedure for amendments to be made to the Companies Act 1956?
Which government bodies and departments were responsible for the amendments to the Companies Act 1956?

B11 Who was consulted about the 1973, 1974 and the 1988 amendments, and who influenced the amendments?

B 12 Once the Companies Act was amended, what was the reaction to the 1973, 1974 and 1988 amendments?

B 13 Who established the Sachar committee and why? Who were the members of the Sachar committee?

B 14 Who was consulted by the committee and who influenced the committee?

B 15 Why were the recommendations of the Sachar committee not accepted?

Revision of the Companies Act 1956 in 1997 to create the Companies Act 1997.

B 16 Who initiated the Companies bill 1997 and why?
What was the background to the Companies bill 1997?

B 17 Why was it necessary to completely revise the Companies Act 1956?

B 18 What was the procedure for promulgating the Companies bill 1997 and who influenced the change?

Which government bodies and departments were responsible for the Companies bill 1997?

B 19 What are the reasons for the new provisions in the Companies bill 1997, for example:

- the requirement for companies to prepare consolidated accounts
- the requirement for companies to appoint a chief accounts officer
- the constitution of a National Advisory Committee on Accounting Standards
- powers for government to appoint a director general of inspection and investigation
- the constitution of a company law tribunal

B 20 What has been the reaction to the Companies bill 1997?
What is the latest position with regards to the Companies bill 1997?

Change 2 - Setting up of the Institute of Chartered Accountants of India (ICAI)

C 1 What was the state of accounting in India at independence, before the ICAI was set up?

C 2 Who initiated the setting up of the ICAI and why?
What was the background to the setting up of the Institute?

C 3 What was the process for setting up the Institute and how was the Institute constituted?

C 4 The ICAI was set up in a similar way to the Institute of Chartered Accountants of England and Wales (ICAEW). Why was this?

What were the differences between how the ICAI was set up and the ICAEW?

C 5 Who was consulted about and who influenced the setting up of the ICAI?

C 6 What was the reaction to the setting up of the Institute?

C 7 Briefly describe the organisational structure and functions of the ICAI.
How have these changed since the ICAI was set up?

C 8 What have the main successes of the ICAI and what have been the main problems faced by the ICAI?

C 9 What is the relationship (if any) between the ICAI and

- the Institute of Cost and Works Accountants of India
- the Institute of Chartered Secretaries of India
- the government and Parliament
- (SEBI) / the stock exchanges
- the professional auditing firms
- the Comptroller and auditor general and the public sector
- the high court
- companies
- financial institutions
- the tax authorities in general and the Central Bureau of Direct taxes in particular

Change 3 - The setting up of the accounting and auditing standard setting process by the Institute of Charted Accountants of India

D 1 Did the ICAI issue any accounting or auditing statements before accounting and auditing standards were issued in 1977?

D 2 Who initiated the setting up of the accounting and auditing standard setting process? Why were accounting and auditing standards needed?

D 3 What was the process for introducing standard setting by the Institute?

D 4 What was the organisational structure constituted for setting standards?

D 5 The standard setting program of the ICAI was set up in a similar way to the standard setting program of the Institute of Chartered Accountants of England and Wales. Why was this?

D 6 What was the reaction to the standards set by the Institute?
Has the reaction to the standard setting process changed over time?

D 7 Briefly describe the standard setting process including:

- Who decides which topics will be addressed and how?
- How does the Institute get feed back from users and preparers on its accounting and auditing standards?
- Who is consulted by the Institute about exposure drafts and standards and who influences the standard setting process?
- Whether international accounting standards and developments in other countries are taken into account at all?

D 8 Has the standard setting process changed since 1977?
Has the representation of the wider interest group changed since 1977?
Is the ICAI becoming more proactive in setting accounting standards?

D 9 How are the standards enforced? Has there been any changes in how the standards are enforced since 1977?

D 10 Is there any government involvement in standard setting by the ICAI ?

D 11 Is there any conflict between accounting standards and other forms of regulation?

D 12 How is the ICAI likely to develop in the future?

D 13 What is the reaction of the Institute to other bodies issuing accounting standards, for example the cashflow statement requirement and tax standards?

D 14 What is the status of international accounting standards in India?
In your opinion, should international accounting standards be used in India?
Should international accounting standards be modified to take into account the social and economic context of India?

Change 4 - The setting up of the Institute of Cost and Works Accountants of India (ICWAI) and the requirement for cost accounting and cost audit

The Setting up of the ICWAI

E 1 What was the position of cost accounting before the ICWAI was set up?

E 2 Why was the ICWAI set up? Why was it necessary to set up a separate institute for cost accounting?

E 3 Who was consulted about, and who influenced the setting up of the ICWAI?

E 4 What was the reaction to the setting up of the ICWAI?

E 5 Briefly describe the organisational structure of the ICWAI. What are the roles and aims of the ICWAI? Have these changed since the ICWAI was set up?

E 6 What is the relationship (if any) between the ICWAI and:

- the Institute of Charted Accountants of India
- the Institute of Chartered Secretaries of India
- the government and Parliament
- (SEBI) / the stock exchanges
- the professional auditing firms
- the Comptroller and auditor general and the public sector
- the high court
- companies
- the tax authorities in general and the Central Bureau of Direct taxes in particular

E 7 How is the ICWAI involved in cost accounting and in cost auditing?

Cost accounting requirements

E 8 When were cost accounts first required?
Who initiated these cost accounting requirements and why were they needed?

E 9 What was the process for introducing the cost accounting requirements and which government departments and bodies were involved in the promulgation of the cost accounting regulations?

E 10 Who was consulted about and who influenced the requirement for cost accounts to be kept by companies?

E 11 What was the reaction to the requirement for cost accounts to be kept by companies?

E 12 Briefly describe the main cost accounting regulations?

E 13 Which companies are required to keep cost accounts and who specifies what information is kept under the cost accounting regulations?

E 14 How are the cost accounting requirements enforced?

E 15 Have the cost accounting regulations changed since they were issued? If so, why?

Cost auditing requirements

E 16 Who initiated the cost audit requirements and why were they needed? What was the background to the cost audit requirement?

E 17 What was the process for introducing the cost audit requirements and which government departments and bodies were involved in the promulgation of the cost auditing regulations?

E 18 Who was consulted about and who influenced the cost audit requirement?

E 19 What was the reaction to the cost audit?

E 20 Briefly describe the cost audit provisions?

E 21 Which companies are required have cost audits? What qualifications are cost auditors required to have and what regulations do they have to follow.

E 22 Have the cost auditing regulations changed since they were issued? If so, why?

Change 5 - SEBI, the stock exchanges and accounting regulation for example cashflow statements

The stock exchanges

F 1 Briefly describe the history of the stock exchanges in India.

F 2 Briefly describe the organisational structure of the Bombay / National stock exchange? (Why was the national stock exchange set up)

F 3 What are the roles and aims of the stock exchanges?

F 4 How do the stock exchanges use accounting reports?

F 5 When were accounting regulations first issued by the stock exchanges?

F 6 What are the main regulations issued by the stock exchanges, both for companies wishing to list on the exchanges for the first time and annual reporting requirements?

F 7 What was the process for issuing the accounting regulations and why were they needed?

F 8 Who was consulted about and who influenced the regulations.

F9 What was the reaction to the regulations issued?

F 10 Do the stock exchanges issue accounting regulations that are different from the Companies Act and/or accounting standards issued by the ICAI.

F 11 What is the relationship (if any) between the stock exchanges and:

- the Institute of Chartered Accountants of India
- The Institute of Cost and Works Accountants of India
- the Institute of Chartered Secretaries of India
- the government and Parliament
- SEBI
- the professional auditing firms
- the Comptroller and auditor general and the public sector
- the high court
- companies
- financial institutions
- the tax authorities in general and the Central Bureau of Direct taxes in particular

F 12 Are the stock exchanges becoming more proactive in accounting regulation?

Change 6 - The tax audit requirement and standards set by the Central Board of Direct Taxes (CBDT)

The tax audit

G 1 Briefly describe the organisational structure of the tax authorities in India.

G 2 What are the role and aims of the tax authorities? How have these changed since independence?

G 3 Have the tax laws and tax authorities affected accounting in any way since independence, either directly or indirectly?

G 4 What is the relationship (if any) between the tax authorities and the CBDT and:

- the Institute of Cost and Works Accountants of India
- the Institute of Chartered Secretaries of India
- the government and Parliament
- (SEBI) / the stock exchanges
- the professional auditing firms
- the Comptroller and auditor general and the public sector
- the high court
- companies
- financial institutions

G 5 Who initiated the tax audit requirements and what was the background to the tax audit requirement?

What was the process for issuing the tax audit requirements and why were they needed?

G 6 Who was consulted about and who influenced the requirement for tax audits?

G 7 What was the reaction to the requirement for tax audits?

G 8 Briefly describe the main tax audit requirements.

G 9 Which companies are required to have tax audits and who carries out the tax audits?

Accounting Standards set by the tax authorities

G 10 Who initiated the recent setting of accounting standards by the tax authorities?

G 11 What was the process for issuing tax accounting standards?

G 12 Who was consulted about and who influenced the this process?

G 13 What was the need for the tax authorities to issue accounting standards in addition to those set by the ICAI?

G 14 What was the need for accounting standards in the areas of accounting policy disclosure and accounting policy change when regulations in these areas were already extant, both in the Companies Act and in accounting standards?

G 15 Was there any opposition to the tax authorities setting accounting standards?

G 16 What has been the reaction to the tax accounting standards?

G 17 How do the tax authorities get feedback on the tax standards from users and preparers of accounts?

G 18 Are there any plans for the tax authorities to get more involved in setting accounting regulations?

Appendix 6

Interviewees

	Company name	date	tape / notes	interviewee
1	Ingersoll Rand	27th October 1998	notes	MM Gandhi
2	Telco	29 October 1998	tape	Mr Kadle
3	National Stock Exchange	2nd November 1998	tape	Mr RH Patil
4	CEAT	2nd November 1998	tape	Mr Tamhane
5	KPMG	3rd November 1998	tape	Mr Balaswaminathan
6	Billlimoria	3rd November 1998	tape	Mr Malegam
7	Fergusons	4th November 1998	tape	Mr Kale
8	Philips	5th November 1998	tape	Mr TK Das
9	Grasim	5th November 1998	tape	Mr Saboo
10	Bombay Stock Exchange	5th November 1998	notes	Mr Ghonaski
11	Glaxo	5th November 1998	tape	Mr Kapadia
12	SEBI	6th November 1998	notes	Mr Kakar
13		6th November 1998		Mr Bindhlish
14	Academic	7th November 1998	tape	Prof Bannerjee
15	DCA	10th November 1998	notes	Mr RD Joshi
16	DCA	17th November 1998		Mr Krishna Murty
17	Tax	16th November 1998	notes	Mr Mathur
18	ICAI	9th November 1998	tape	Rahul Roy
19	ICAI	18th November 1998	tape	Mr AK Bhattacharya
20	ICWAI	17th November 1998	tape	Mr Jagganathan
21	ICSI	20th November 1998	notes	VK Aggarwal
22	Academic	29th September in UK	tapes	Prof Narayanaswamy

Appendix 7

Key ministries of the Government of India

Ministry of Agriculture
Ministry of Chemical and Fertiliser
Ministry of Civil Aviation and Tourism
Ministry of Civil Supplies, Consumer Affairs and Public Distribution
Ministry of Coal
Ministry of Commerce
Ministry of Communications
Ministry of Defence
Ministry of Environment and Forests
Ministry of External Affairs
Ministry of Finance
Ministry of Food
Ministry of Food Processing Industries
Ministry of Health ad Family Welfare
Ministry of Home Affairs
Ministry of Human Resources Development.
Ministry of Industry
Ministry of Information and Broadcasting
Ministry of Labour
Ministry of Law and Justice
Ministry of Mines
Ministry of Non-Conventional Energy Sources
Ministry of Parliament
Ministry of Personnel, Public Grievances and Pensions
Ministry of Petroleum and Natural Gas
Ministry of Planning and Programme Implementation
Ministry of Electricity
Ministry of Railways
Ministry of Rural Areas and Employment
Ministry of Science and Technology
Ministry of Steel
Ministry of Water and Surface Transport
Ministry of Textiles
Ministry of Urban Affairs and Employment
Ministry of Water Resources
Ministry of Welfare
Department of Atomic Energy
Department of Electronics
Department of Ocean Development
Department of Space
Cabinet Secretariat
President's secretariat
Prime Minister's Office
Planning Commission

Appendix 8

Listing requirements

- Companies who are listing for the first time or companies who making an additional listings on the stock exchange must provide information which includes

- prospectus with five year trading history
- statement of what the funds are required for
- future cashflow budget
- risk factors attached to projects

- all companies listed on the stock exchange are required to provide information which includes:

- unaudited quarterly financial results in prescribed formats must be forwarded to the stock exchange
- copies of annual reports, notices of resolutions and circulars must be forwarded to the stock exchange.
- a cashflow statement must be published, in a format specified by the stock exchange. Cashflow statements are usually given as part of the annual report by listed companies.
- notification of any shareholdings of more than 5% of company shares must be given to the stock exchange, within two days of any such acquisition
- any take-over offer requires public announcement
- the company will give the stock exchange key financial information after the meeting of its Board of directors
- annual statutory accounts , all periodicals and any other special reports must be forwarded to the stock exchange.

Appendix 9

Voluntary Disclosures

Voluntary disclosures are made as follows:

Given by more than 70% of companies

details of holding co if relevant and collaborations

employee relations and thanks to employees

some organisational details - board of directors and possibly other key employees

current year financial highlights statement

financial highlights or summaries - up to 10 years

Given by 50% - 70% of Companies

profitability ratios

Given by 20-50 % of the companies

general strategy statements

future prospects statement (qualitative)

training policy

qualitative information on environmental protection programs

distribution of revenue / value added statement

general community programs

gearing ratios

liquidity ratios

Given by 10-20% of companies

deferred tax

statement of source and application of funds statement

categories of staff trained

nature of training

liquidity and cashflow ratios

year end share price information

market capitalisation information

Other - < 10% of Companies disclosing

brief history of companies

financial strategy

social strategy

marketing strategy

impact of strategy on results

location of R+D

number of employees trained

amount spent on training

general welfare of employees

general safety

charitable donation

contribution to government exchequer

thanks to financial institutions and government departments

brand valuation

share price trend information

Appendix 10

List of witnesses to the Company Law Committee of 1952

Association	Number of representations	%
Chambers of commerce and trade associations	72	55.4
Stock exchanges	13	10.0
Companies and business owners	11	8.5
Law associations and representatives	7	5.4
Registrar	6	4.6
Employees representatives	5	3.8
Government	4	3.1
Shareholder associations	4	3.1
Individuals (no associations given)	3	2.3
Banks	2	1.5
Journalist	2	1.5
Liquidator	1	0.8
total	130	100

Appendix 11

Witnesses to the Joint Committee on the Companies Bill 1953

Name of Association

The Associated Chambers of Commerce of India, Calcutta
The Bombay Incorporated Law Society, Bombay
The Bombay Shareholders Association, Bombay
The Employers Federation of India, Bombay
The Federation of Working Journalists, New Delhi
The Incorporated Law Society, Calcutta
The Indian National Trade Union Congress, New Delhi
The Institute of Chartered Accountants of India, New Delhi

Appendix 12

The main criticisms of the Companies Bill 1956 *(The Report of the Joint Committee, 1953, Indian Parliamentary debates on 2nd to 10th September 1955.*

Criticisms by those in favour of business

The Bill was too long and too complex.

There were too many regulations to try and control directors and managing agent and to stop abuses and malpractices in the corporate sector. Instead of improving the running of companies, this had led to too many restrictions on business which prevented the smooth running of business and economic development.

Too many powers were given to the Government leading to the involvement of Government in even minor areas of corporate life rather than letting directors manage the companies and make key decisions for example relating to remuneration.

The managing agency system was being regulated too strongly such that it was being effectively abolished. The managing agency system was important in India and needed to be reformed, not abolished

The Bill introduced too much bureaucracy for the corporate sector. In particular the number of forms and amount of information that companies had to provide was very onerous.

Much of the drafting of the Act was loose such that provisions were ambiguous and unclear.

There should be a right of appeal to the high courts rather than to Government to ensure that Government did not abuse its powers over the corporate sector.

The powers of investigation and inspection were too wide and might lead to harassment of those being investigated or inspected.

An independent central authority needed to be set up to administer and enforce the Companies Act.

Appendix 12 (cont)

The main criticisms of the Companies Bill 1956 (cont.)

Criticisms by those against business

The Bill was too long and too complex.

The Companies Bill was half hearted and did not tackle the problems in the managing agency system which had responsible for many malpractices and abuses in the corporate sector. It had also led to the concentration of economic wealth in the hands of a few. The managing agency system had to be completely abolished.

Labour played an important role in modern industry and business, as important a role as capital or management. However labour was not represented on the Board of Directors and did not get a fair share of the profits of the company which accrued mainly to management and shareholders. Board representation would also help to improve industrial relations and corporate efficiency.

Further controls were needed in the corporate sector, particularly on the bigger businesses, since the concentration of wealth and power in the hands of a few businesses was detrimental to achieving the socio-economic aims and objectives of the Government.

There were some private companies, often family run, which are very large and where there was a public interest. These companies should be made to follow the disclosure and reporting requirements that public companies had to follow.

The audit and accounts provisions were criticised as being influenced too much by the auditing profession. Government appointment of auditors was suggested in the short tem and in the long term, a Government run national audit service under the Comptroller and Auditor General should be considered.

An independent central authority needed to be set up to administer and enforce the Companies Act.

Appendix 13

Analysis of representations received by the Company Law Amendment Committee

Name	Written evidence	%	Oral [1] evidence	%
Individuals not identified	89	36.5	1	2.0
Companies and firms	45	18.4	3	6.1
Chambers of commerce	27	11.2	12	24.6
Trade and business associations	17	7.0	2	4.1
Representatives of Chartered Accountants	12	4.9	4	8.2
Representatives of the Law	10	4.1	9	18.4
Representatives of Investor associations	9	3.7	4	8.2
Banking and insurance	5	2.0	2	4.1
Stock Exchanges	5	2.0	3	6.1
Millowners associations	4	1.7	2	4.1
Other	4	1.7	0	0
Company Secretaries	3	1.2	1	2.0
Advertising associations	2	0.8	0	0
Colleges	2	0.8	0	0
Cost and Works accountants	2	0.8	1	2.0
Import/ export associations	2	0.8	0	0
Audit	1	0.4	0	0
Businessman	1	0.4	0	0
Employee associations	1	0.4	0	0
Journalist	1	0.4	1	2.0
Official liquidator	1	0.4	1	2.0
Registrar of companies	1	0.4	1	2.0
Department of company law administration	0	0	2	4.1
Total	244	100.0	49	100.0

[1] Including some individuals who did not give written evidence but were invited to give oral evidence

Appendix 14

Parties making submissions to the joint committee on the Companies (Amendment) Bill 1974

List of Associations and organisations from whom memorandum were received

Association	Number of representations	%
Chambers of commerce and trade associations	45	34.6
Chartered Accountants	21	16.2
Companies and business owners	13	10.0
Individuals (no associations given)	12	9.2
Law associations and representatives	8	6.2
Employees representatives	7	5.4
Stock exchanges	5	3.8
Company Secretaries	4	3.1
Shareholder associations	4	3.1
Cost Accountants	3	2.3
Other **(see note 1 below)**	8	6.1
total	130	100

Note 1
Other includes 1 representation from each of the following:

Investment credit / finance representatives
Member of Parliament
Young Entrepreneurs
India, Pakistan and Bangladesh Association (London)
Andheri Homeopathic Centre
MRTP commission
Management Consultants
academics

Appendix 15

Parties giving oral evidence to the joint committee on the Companies (Amendment) Bill 1974

Ahmedabad Millowners' Association, Ahmedabad
Associated Chambers of Commerce and Industry of India, New Delhi
Association of Chartered Accountants of Calcutta
Bar Library Club, Calcutta
Bengal National Chamber of Commerce and Industry, Calcutta
Bharat Chamber of Commerce, Calcutta
Bombay Chamber of Commerce and Industry, Bombay
Bombay Shareholders Association, Bombay
Bombay Study Circle on Corporate Law and Allied Subjects
Calcutta Trades Association, Calcutta
Central India Chamber of Commerce and Industry, Ujjain
Chartered Accountant, employees of Messrs Lovelock & Lewes
Chartered Accountants' Association for Nationalisation of Audit Profession and Services, Calcu
Company Secretaries of certain public limited companies in Bombay
DCA, Government of India
Federation of Indian Chambers of Commerce & Industry, New Delhi
G Basu & Companies, Employees Association, Calcutta
Incorporated Law Society of Calcutta
Indian Chambers of Commerce, Calcutta
Institute of Company Secretaries, New Delhi
Lovelock & Lewes Employees's National Union, Calcutta
Madhya Pradesh Chamber of Commerce & Industry, Gwalior
Madhya Pradesh Organisation of Industry, New Delhi
Madhya Pradesh Textile Mills Association, Indore
Madras Shareholders Association, Madras
Madras Stock Exchange, Madras
Maharatta Chamber of Commerce and Industry, Poona
Merchants Chamber of Commerce, Calcutta
Millowners' Association, Bombay
Mysore Chamber of Commerce and Industry, Bangalore
National Forum of Shareholders, Calcutta
Northern India Shareholders Association, New Delhi
Price Waterhouse, Peat & Companies Employees's Union, Calcutta
Professor KT Merchant, member, company law advisory committee
Public Financial Institutions - Reserve Bank of India, Industrial Development Bank of India, Ind
Credit and Investment Corporation of India, Unit trust of India,
Punjab, Haryana and Delhi Chamber of Commerce and Industry, New Delhi
Ray & Ray Employees Union, Calcutta
Shri FR Ginwalla, Corporate Law advisor, Bombay
Shri HB Dhondy, Chartered Accountant, Bombay
Shri N Dandekar, ICSI (retired), Chartered Accountant, Bombay
Shri SS Kothari, ex MP
Stock Exchange, Bombay
The Association Practising Cost Accountants of India, Calcutta

Appendix 15 (cont)

The Bengal Chamber of Commerce and Industry
The Chartered Institute of Secretaries of India, Calcutta
The Committee of Younger Partners of the Established Auditing firms, Calcutta
The Indian Merchants Chamber, Bombay
The Institute of Chartered Accountants of India, New Delhi
The Institute of Cost and Works Accountants of India
The Madras Chamber of Commerce & Industry, Madras
The Southern India Chamber of Commerce and Industry, Madras
The Young Chartered Accountants Forum, Calcutta
Western India Young Chartered Accountants Forum, Bombay
Yuva Krantikari Parishad, Jaipur

This is analysed as follows:

Association	**Number of representations**	**%**
Chambers of commerce and trade associations	21	36.2
Chartered Accountants	7	12.1
Public Financial Institutions	6	10.3
Law associations and representatives	5	8.6
Employees representatives	4	6.9
Shareholder associations	4	6.9
Company Secretaries	3	5.2
Stock exchanges	2	3.5
Cost Accountants	2	3.5
Companies and business owners	1	1.7
Individuals (no associations given)	1	1.7
Retired Member of Parliament	1	1.7
Department company affairs	1	1.7
total	58	100

Appendix 16

The members of the 1997 Working Group on the Companies Act 1956 *(The Report of the Working Group on the Companies Act 1956, pages 1 to 3)*

Dr KR Chandrate, President of the Institute of Company Secretaries of India

Dr Omkar Goswami, India Statistical Institute, New Delhi

Mr Rajendra S Lodha, Senior Partner, Lodha & Co – representative of cost accounting firm

Mr DS Mehta, Advisor, Bajaj Auto Limited

Mr S Ramaiah, Retired Secretary (Legislative), Government of India

Mr MK Sharma, Director (Legal and Secretarial) Hindusthan Lever Limited

Mr Shardul S Schroff, Partner, Amarchand & Mangaldas & Suresh A. Schroff & Co – representative of auditing firm

Mr BB Tandon, Additional Secretary, Department of Company Affairs, convenor – replaced in last six months by Mr TS Krishna Murthy, Secretary of Department of Company Affairs

Appendix 17

Parties interacting with the 1997 Working Group *(Interviews with senior government officials, senior accounting personnel in companies, senior members of the ICAI, partners in auditing firms and academics in India in October / November 1998; Report of the Working Group on the Companies Act 1956; (Chidambaram P., Statement of Objects and Reasons, 1997)*

Auditing and accounting firms

Banks

Capital market players

Companies

Employee representatives for example trade unions

Financial Institutions

Government Departments for example Department of Company Affairs, Central Board of Direct Taxes

Industry Associations for example Association of Chambers of Commerce in India (ASSOCHAM), Federation of Indian Chambers of Commerce in India (FICCIE) and Confederation of Indian Industry (CII)

Members of Parliament

Merchant Bankers

Professional accounting bodies for example The Institute of Chartered Accountants of India (ICAI), the Institute of Cost and Works Accountants of India (ICWAI) and the Institute of Company Secretaries of India (ICSI)

Professional Legal associations

Stock Exchanges (for example Bombay Stock Exchange, National Stock Exchange)

The Reserve Bank of India

The Securities and Exchange Board of India (SEBI)

Appendix 18

Contents of the Chartered Accountants Act, 1949

- Incorporation of the Institute
- Entry of names into register
- Fellows and Associates
- Certificate of Practice
- Members to be known as chartered accountants
- Disabilities
- Constitution of the Council of the Institute
- Mode of election to the Council
- Nomination in default of election or nomination
- President and Vice President
- Resignation of membership and casual vacancies
- Duration and dissolution of Council
- Functions of the Council
- Staff, Remuneration and Allowances
- Committees of the Council
- Finances of the Council
- Register of members
- Removal from Register
- Procedure in inquiries on the misconduct of members of the institute
- Professional misconduct defined
- Appeals
- Constitution and function of regional councils
- Penalty for falsely claiming to be a member
- Penalty for using the name of the Council
- Companies not to engage in accountancy
- Unqualified persons not to sign documents
- Maintenance of branch offices
- Sanction to prosecute
- Reciprocity
- Power to make regulations
- Powers of the Central Government to direct regulations to be made
- Laying of regulations
- Construction of references
- Act not to affect right of accountants to practise as such in acceding states

Appendix 19

Accounting Standards Issued by Accounting Standards Board of the ICAI.*(Agarwal R.K., 1997)*

Accounting Standard	Title	Date of issue, Date of revision, Date of being made mandatory
AS 1	Disclosure of accounting policies.	Issued 1979, mandatory 1991
AS 2	Valuation of inventories	Issued 1981, revised exposure draft 1998, not mandatory
AS 3	Changes in financial position	Issued 1981, not mandatory
AS 4	Contingencies and Events occurring after the balance sheet	Issued 1982, revised 1995, mandatory 1987
AS5	Prior period and extraordinary items and changes in accounting policies	Issued 1982, mandatory 1987
AS 6	Depreciation accounting	Issued 1982, revised 1994, not mandatory
AS 7	Accounting for construction contracts	Issued 1983, mandatory 1991
AS 8	Accounting for research and development	Issued 1985, mandatory 1991
AS 9	Revenue recognition	Issued 1985, mandatory 1991
AS 10	Accounting for fixed Assets	Issued 1985, mandatory 1991
AS 11	Accounting for effects of changes in foreign exchange rates (revised)	Issued 1989, revised 1994, mandatory 1991
AS 12	Accounting for Government Grants	Issued 1992, mandatory 1994
AS 13	Accounting for Investments	Issued 1994, mandatory 1995
AS 14	Accounting for Amalgamation	Issued 1994, mandatory 1995
AS 15	Accounting for Retirement Benefits	Issued 1994, mandatory 1995

Appendix 20

Groups whose view is taken by the ICAI in its standard setting process.

(interviews with senior accounting personnel in companies on 27th October 1998 29th October 1998, 2nd November 1998 and 5th November 1998; interview with senior Indian academic on 28th September 1998; interviews with senior members of the accounting profession on 3rd November 1998, 4th November 1998, 9th November 1998 and 18th November 1998Agarwal R.K., 1997; Mohana Rao P., 1994, pages 278 to 293; Chakravorty D.K., 1994, pages 38 to 43, chapter 4; Porwal L.S., 1993, pages 121 to 140; interviews with senior accounting personnel in companies on 27th October 1998 29th October 1998, 2nd November 1998 and 5th November 1998)

Banks

Central Board of Direct Taxes

Company Law Board

Comptroller and Auditor General (C&AG)

Financial institutions

Government Finance Officers

Indian Accounting Association

Indian Institute of Management

Institute of bankers

Institute of Company Secretaries of India (ICSI)

Institute of Cost and Works Accountants of India (ICWAI)

Mutual funds

Public enterprise

Public Sector Accountants

Securities and Exchange Board of India (SEBI)

Shareholders Association

Trade Associations

Universities

Appendix 21

Written representations received by the joint select committee

(Report of the joint select committee on the Cost and Works Accountants Bill 1958, appendix iii)

Organisations

Federation of Indian Chambers of Commerce and Industry, New Delhi

Institute of Cost and Works Accountants of India, Calcutta

Institute of Chartered Accountants of India, New Delhi

Society of Auditors, Madras

Bombay Chartered Accountants Society, Bombay

Members of the Eastern Region of the Institute of Chartered Accountants

Individuals (affiliations not given)

Shri Sunil Chakraborty on behalf of 200 individuals

Shri W.N.S. Chari, Madras

Shri S.V. Ayyar, Calcutta

Shri N.T. Dalal, Bombay

Shri S Suryanarayan, Madras

Appendix 22

Oral representations given to the joint select committee *(Report of the joint select committee on the Cost and Works Accountants Bill 1958, appendix iv)*

The Federation of Indian Chambers of Commerce and Industry (FICCI) (4 representatives)

The Institute of Cost and Works Accountants of India (ICWAI) (7 representatives)

The Society of Auditors, Madras and Mysore State Chartered Accountants Institute (1 representative)

Bombay Chartered Accountants Society (3 representatives)

Shri Sunil Chakraborty

Shri N.K. Bose

Appendix 23

The requirement for the maintenance of cost accounting records

(Section 209(1) (d) of the Companies Act 1956; Gupta K., 1992, chapter 11)

The cost accounting records rules generally consist of three parts:

- descriptive rules, including definitions and applicability clauses
- description of procedures for compilation of costs under each element and pro-forma for collection and allocation of service centre costs
- pro-forma of cost statements

The cost accounting rules require that the books of account be kept in a manner that the cost of production and cost of sale during the financial of the year of the company can be properly calculated in the forms prescribed for each industry separately.

The books of account should also contain the prescribed elements of costs e.g. materials, wages, stores and overheads.

In cases, where a company is manufacturing other products in addition to the products covered by the rules, it is provided that the records should be kept so that the cost of other products is not included in the cost of production of the product covered by the rules.

In the case of process industries, the prescribed cost statements are such that the cost of production is shown separately for each process.

In the case of engineering industries, the cost statements collect the costs of different components or sub-assemblies first and then the cost of final assembly is shown.

Appendix 24

Industries which are required to maintain cost accounting records and which have to have cost audits when directed by Government *(Gupta K., 1992, chapter 11)*

Cement
Cycles
Rubbers, tyres and tubes
Caustic soda
Room air conditioners
Refrigerators
Automobile batteries
Electric lamps
Electric fans
Electric motors
Motor vehicles
Tractors
Aluminium
Vanaspati
Bulk Drugs
Sugar
Infant milk food
Industrial alcohol
Jute goods
Paper
Rayon
Dyes
Soda ash
Nylon
Polyester
Cotton textiles
Dry battery cell
Sulphuric acid
Steel tubes and pipes
Engineering industries (power driven pumps, diesel engines, internal combustion engines)
Electric cables and conductors
Bearing
Milk food
Chemical industries
Synthetic resins and plastics
Formulations

Appendix 25

The cost audit requirement *(Section 233(b) of the Companies Act 1956; the Cost audit (report) rules 1968; Gupta K., 1992, chapter 11)*

The cost audit (report) rules 1968 (last amended in 1986) prescribe the rules regarding the cost audit report. Some of the more important rules cover:

- time limit for the audit report
- form of the audit report
- authentication of the audit report.
- annexure to the cost audit report covering:
- general information
- description of cost accounting system
- financial position of the company
- production details
- process of manufacture
- raw materials
- power and fuel
- wages and salaries
- stores and spare parts
- depreciation
- overheads
- royalty and technical aid
- sales
- abnormal and recurring costs
- auditors observations and conclusions

Appendix 26

Main provisions of the Income tax Act 1961 relating to the tax audit

- compulsory audit required if total sales or turnover exceed specified amounts which are revised periodically. Currently for companies with turnover of over 40 lakhs. *(Section 44AB of Income Tax Act, 1961)*

- the audit must be conducted by chartered accountant and authoritative opinion is that the accountant must have certificate of practice. *(Section 288(2) of Income Tax Act, 1961)*

- The tax audit report must be in a specified format. In the tax audit report, the tax auditor is required to express his opinion as to:

  - whether or not the financial statements give a true and fair view of the profit and loss account and the state of affairs of the company

  - whether or not the prescribed particulars contained in the statement of particulars, annexed to the audit report are true and correct.

(Section 44AB of the Income Tax Act 1961)
(Rule 6G of the Income Tax Rules, 1962

- The statement of Particulars annexed to the tax audit report must confirm whether the following particulars are true and correct:

  - the books of account that have been examined

  - the method of accounting employed and if there has been any change in this

  - stock valuation methods and any changes to these

  - amount of expenditure on

    - capital expenditure debited to the P+L account
    - personal expenses debited to the P+L account
    - advertising expenditure outside India
    - items published by a political party
    - travelling expenses
    - maintenance of guest house accommodation
    - entertainment
    - scientific research
    - bonus or commission to employees
    - payments made to clubs

- interest, salary, bonus, commission or remuneration to partners of a firm, if the assessee is a firm

- details of the following expenditure:

  * payments made to persons specified in section 40A(2) of the Income tax Act
  * payments in excess of 10,000 rupees otherwise than by crossed cheque
  * provision for payment of gratuity and whether gratuity fund is approved by the tax authorities
  * sums paid that are disallowable under Section 40A(9) of the Income Tax 1961 for example payments by employer towards setting up societies

- details of tax, duty or other sum debited to the profit and loss account but not paid and details of tax, duty or other sum paid but allowed as deduction in previous years

- particulars of

  * proforma credits / drawbacks / refund of duties of customs or sales tax due where these are not credited in the P+L account
  * expenditure / income of any earlier years debited / credited to the P+L account of the relevant previous year
  * particulars of any contingent liability debited to the P+L account

- Particular of loans and deposits over 20,000 rupees and repayments of these

- Whether the assessee has deducted tax at source and paid this to the central government. If not, details must be given.

- In the case of manufacturing concerns. full quantitative details of principal items of raw materials and finished products

  * opening stock
  * purchases during the year
  * consumption during the year
  * sales during the year
  * closing stock
  * yield of finished products
  * percentage of yield
  * shortage and percentage thereof

- in the case of a company, details of

* any expenditure which has resulted directly or indirectly in the provision of any remuneration, benefit or amenity to any director, any person who has substantial interest in the company or any relative of such persons.

* any expenditure or allowance in respect of assets of the company used wholly or partly for the benefit of the persons referred to above

(Section 44AB of the Income Tax Act, 1961)

(Rule 6 of the Income Tax Rules, 1962

(Clauses 1 to 13 of tax firm 3CD)

(Gupta, K., 1992, chapter 15)

Appendix 27

The main provisions of Tax accounting standard 1 issued by the CBDT.

The standard deals with the disclosure of significant accounting policies followed in preparing and presenting financial statements and is to be followed by all assessees following the mercantile system of accounting.

The standard defines accounting policies as the many principles, bases, conventions, rules and procedures adopted by management in preparing and presenting financial statements. Enterprises may adopt any suitable accounting policies and should follow these consistently unless circumstances warrant a change. If changes are made to accounting policies, these must be disclosed.

Accounting polices should be disclosed , normally in one place.

Any changes in accounting policies which have a material effect should be disclosed. The impact of, and the adjustment relating to policy changes should be disclosed in the year of change. If the impact is not ascertainable, this should be mentioned. If the policy change has no immediate material impact but is likely to material affect future accounting periods, this should be stated.

Accounting policies adopted by the assessee should be so as to show a true and fair view of the state of affairs of the business, profession or vocation. The major considerations governing the selection and application of the accounting policies are:

- **prudence** - provisions should be made for all known liabilities and losses even if estimates are made
- **substance over form** - accounting treatment and presentations should be governed by substance and not just legal form
- **materiality** - financial statements should disclose all material items, the knowledge of which might influence the decisions of the users of the financial statements

If the four fundamental accounting assumptions of going concern, consistency and accruals are not followed, this should be disclosed. If the fundamental accounting assumptions are followed, this does not need to be disclosed.

The standard defines financial statements,accruals, consistency and going concern as follows;

- **financial statements** means any statement to provide information about the financial position, performance and changes in the financial position of the assessee and includes balance sheet, profit and loss account and other statements and explanatory motes forming part thereof

- **accruals** refers to the assumption that revenues and costs are accrued, that is, recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate

- **consistency** refers to the assumption that accounting policies are consistent from one period to another

- **going concern** refers to the assumption that the assessee has neither the intention nor the necessity of liquidation or of curtailing materially the scale of business, profession or vocation and intends to continue his business, profession or vocation for the foreseeable future.

Appendix 28

The main provisions of Tax accounting standard 2 issued by the CBDT

This standard deals with prior period items, extraordinary items and changes in accounting policies.

Key definitions and accounting treatments are given as follows:

- **Prior period items** are material charges or credits which arise in the previous year as a result of errors and omissions in the preparation of the financial statements of one or more previous years. Prior period items are not changes in estimates of contingencies.

  Prior period items should be separately disclosed in the profit and loss account so that the effect of the prior period items can be perceived.

- **extraordinary items** are gains or losses which arise from events or transactions which are distinct from the ordinary activities of the business and which are both material and expected not to recur frequently or regularly. Extraordinary items include material adjustments necessitated by circumstances which though related to previous years are determined in the current accounting period.

  Extraordinary items should be disclosed in the Profit and loss account as part of income. The nature and amount of each extraordinary item should be disclosed separately so that their effects may be perceived.

- **accounting policies** means the specific accounting principles and the method of applying those principles adopted by the assessee in the preparation and presentation of financial statements

  Changes in accounting policies should only be made if the change would result in a more appropriate preparation or presentation or if the change is required by statute or regulation. Any changes in accounting policies which have a material effect should be disclosed. The impact of, and the adjustment relating to policy changes should be disclosed in the year of change. If the impact is not ascertainable, this should be mentioned. If the policy change has no immediate material impact but is likely to material affect future accounting periods, this should be stated.

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