



**COMMENTS OF THE COMPTROLLER AND AUDITOR GENERAL OF INDIA UNDER SECTION 619(4) OF THE COMPANIES ACT, 1956 ON THE ACCOUNTS OF NATIONAL AVIATION COMPANY OF INDIA LIMITED FOR THE YEAR ENDED 31 MARCH 2008.**

The preparation of financial statements of **National Aviation Company of India Limited** for the year ended 31 March 2008 in accordance with the financial reporting framework prescribed under the Companies Act, 1956, is the responsibility of the Management of the Company. The Statutory Auditor appointed by the Comptroller and Auditor General of India under Section 619(2) of the Companies Act, 1956 is responsible for expressing opinion on these financial statements under section 227 of the Companies Act, 1956 based on independent audit in accordance with the auditing and assurance standards prescribed by their professional body, the Institute of Chartered Accountants of India. This is stated to have been done by them vide their Audit Report dated 17 December 2008.

I, on behalf of the Comptroller and Auditor General of India, have conducted a supplementary audit of **National Aviation Company of India Limited** under section 619(3) (b) of the Companies Act, 1956 of the financial statements for the year ended 31 March 2008. This supplementary audit has been carried out independently with access to limited working papers of the statutory auditors and is also limited primarily to inquiries of the Statutory Auditors and Company personnel and a selective examination of some of the accounting records. Based on my supplementary audit, I would like to highlight the following significant matters under section 619 (4) of the Companies Act, 1956 which have come to my attention and which in my view are necessary for enabling a better understanding of the financial statements and the related Audit Report:

**A. PROFIT AND LOSS ACCOUNT:**

**Total Revenue:-Rs.152,574.7 million**

1. The Company has accounted for Buyer Furnished Equipment (BFE) credits of Rs.120.9 million in contravention of their Accounting Policy. This has resulted in overstatement of Revenue by Rs.120.9 million and consequent understatement of Loss by a similar amount.

**B. FINANCIAL POSITION**

**BALANCE SHEET**

**APPLICATION OF FUNDS**

**2. Current Assets, Loans and Advances: Rs.62,916.1 million (Schedules G to K)**

- (i) An amount of Rs.2,299 million paid to lessor towards maintenance charges during the year has been accounted for as Prepaid Expenses as per the Company's Accounting Policy M(b). As the amount towards maintenance charges accrues on the basis of flight cycles/hours flown, the maintenance charges paid should have been treated as expenditure as per the accrual basis of accounting. The accounting treatment adopted by the Company has resulted in overstatement of Prepaid Expenses and understatement of Maintenance Expenditure by Rs.2,299 million with consequential understatement of Loss to the same extent.
- (ii) The Company has neither accounted for the revenue of Rs.116.3 million in respect of invoices raised on M/s US Bank Trust National Association during 2007-08 towards ferry flight including crew cost for modification of 777-200 ER aircraft nor disclosed the circumstances in which revenue recognition has been postponed pending resolution of significant uncertainties, if any, as required under AS-9 prescribed under Section 211(3)(C) of the Companies Act, 1956.

**C. AUDITORS' REPORT**

As required under Section 227(3) (g) of the Companies Act, 1956, the Auditors' Report does not disclose payment of cess for the purpose of rehabilitation or revival or protection of assets of the sick industrial company referred to in Section 441A of the Act *ibid*.

**D. OTHERS**

On the basis of re-valuation of Land-freehold, Land-leasehold and Buildings carried out by the registered valuers, the Company incorporated the revised values in the Gross Block amounting to Rs.86,028.9 million in its books of accounts as on 1 April 2007. The revised valuation may be viewed in the light of the following:

- (i) Market rates obtained by the valuers from the broker/agents for valuation of freehold land were not susceptible of verification with documentary evidence. As a result, reasonableness of the values adopted in the books of accounts could not be verified in Audit.



- (ii) Lease hold properties included cancelled leases, non-existent lease agreements *ab initio* and expired lease agreements. The conditions stipulated by the lessor in the lease agreements had also not been fulfilled by the Company.
- (iii) A reference is drawn to the paragraph 5(i) of the Statutory Auditors' Report which states that the fair value amounting to Rs. 51,295.10 million and consequential impact on Capital Reserve of immovable property at Vasant Vihar Housing Colony is subject to reinstatement of lease deed. The paragraph *ibid* is not explicative of the applicability of the standard clause in the lease agreements executed with the Land and Development Officer regarding sharing of 50 per cent of the unearned increase in value even if the lease deed is reinstated in favour of the Company.

For and on behalf of the  
Comptroller & Auditor General of India

Sd/-  
**Sarit Jafa**  
Principal Director of Commercial Audit  
& ex-officio Member, Audit Board-II, Mumbai

Place : Mumbai  
Date : 13 February 2009



MANAGEMENT REPLIES TO THE COMMENTS OF THE COMPTROLLER AND AUDITOR GENERAL OF INDIA UNDER SECTION 619(4) OF THE COMPANIES ACT, 1956 ON THE ACCOUNTS OF THE COMPANY FOR THE YEAR ENDED 31 MARCH 2008.

SR. NO.	SUPPLEMENTARY AUDIT OBSERVATIONS	MANAGEMENT REPLY
A. PROFIT & LOSS ACCOUNT: Total Revenue : Rs. 152,574.7 million  1 The Company has accounted for Buyer Furnished Equipment (BFE) credits of Rs. 120.9 million in contravention of their Accounting Policy. This has resulted in overstatement of Revenue by Rs.120.9 million and consequent understatement of Loss by a similar amount.  B. FINANCIAL POSITION BALANCE SHEET APPLICATION OF FUNDS  2. Current Assets, Loans and Advances: Rs. 62,916.1 million (Schedules G to K)  i) An amount of Rs. 2,299 million paid to less or towards maintenance charges during the year has been accounted for as Prepaid Expenses as per the Company's Accounting Policy M(b). As the amount towards maintenance charges accrues on the basis of flight cycles/hours flown, the maintenance charges paid should have been treated as expenditure as per the accrual basis of accounting. The accounting treatment adopted by the Company has resulted in overstatement of Prepaid Expenses and understatement of Maintenance Expenditure by Rs.2,299 million with consequential understatement of Loss to the same extent.	<p>The Company has accounted Credits as per agreements entered into with the Suppliers of Buyer Furnished Equipment upon delivery of the aircraft on or before 31.03.2008. The accounting policy Para F(a) will be amended accordingly to reflect this change effective accounting year 2008-09</p> <p>The Company follows a policy of charging to Expenditure based on the principle of actual incurrance of the maintenance expenditure. Under the Maintenance Reserve concept, in addition to lease rentals, the company is contributing to Maintenance Reserves for engines, landing gear equipment, APU &amp; airframe. Whilst the reserves contributed for engines are in the nature of a deposit and booked under Prepaid Expenses, the reserves for landing gear equipment, APU &amp; airframes are charged to expenditure in the year of contribution, if the major checks on the landing gears, APU &amp; airframe falls outside the lease period.</p> <p>However, in respect of the engines which are "dropped" during the lease period, the actual expenditure on the maintenance of these engines is drawn from the maintenance reserves as and when the expenditure takes place and therefore booked in the year of actual occurrence/incurrence.</p> <p>Further, there are only 16 aircrafts out of 51 leased aircrafts on lease for which Maintenance Reserves is contributed. In respect of other leased aircraft no Maintenance Reserves are contributed but the expenditure is charged in the year of actual maintenance. This also falls in line with the booking of expenditure in the year of occurrence for the owned aircraft of the Company.</p> <p>It is, therefore, necessary to follow a uniform policy in respect of the leased fleet and the owned fleet wherein maintenance expenses are debited only in the year of actual occurrence/incurrence.</p> <p>The above also is in line with the accounting policies as indicated in the statement of significant accounting policies. This Policy was followed by erstwhile Air India Ltd and Air India Charters Ltd. during the current year and is in line with International practices.</p>	



- ii) The Company has neither accounted for the revenue of Rs. 116.3 million in respect of invoices raised on M/s. US Bank Trust National Association during 2007-08 towards ferry flight including crew cost for modification of 777-200 ER aircraft nor disclosed the circumstances in which revenue recognition has been postponed pending resolution of significant uncertainties, if any, as required under AS-9 prescribed under Section 211 (3)C of the Companies Act, 1956

Provisional invoices were raised during March 2008 on M/s. US Bank Trust National Association for overhaul of one Engine and towards reimbursement of ferry flight expenses for modification of 777-200 aircraft amounting to (USD 2.899 million) Rs.116.33 million.

After scrutiny, Lessor has rejected the entire claim of overhaul of engine to the extent of (USD 2.639 million) Rs.105.90 million as per the terms of the agreement. The other invoices towards ferry cost were settled only in part to the extent of (USD 0.113 million) Rs.4.53 million during 2008-09.

Since the matter has crystallized after thorough scrutiny by the Lessor and substantial part of the claim was rejected finally in October 2008, accounting action could not be taken in 2007-08 and has been subsequently taken in the year 2008-09 for the amount settled Rs.4.53 million as against the provisional invoice of Rs.116.33 million.

#### C. AUDITORS' REPORT

As required under section 227(3)(g) of the Companies Act, 1956 the Auditors' Report does not disclose payment of cess for the purpose of rehabilitation or revival or protection of assets of the sick industrial company referred to in Section 441A of the Act bid.

Section 441(A) of the Companies Act, 1956, is yet to be notified. Therefore, the requirement under section 227 (3)(g) is not applicable.

#### D. OTHERS

On the basis of revaluation of Land-freehold, Land – leasehold and Buildings carried out by the registered valuers, the Company incorporated the revised values in the Gross Block amounting to Rs. 86,028.9 million in its books of accounts as on 1 April 2007. The revised valuation may be viewed in the light of the following:

The methodology adopted by the valuer was based on fair market rates, which is otherwise referred to as the direct sale method. Under the direct sale method, the market rates are obtained from brokers/ agents and the transactions are assessed based on a willing buyer and a willing seller, based on a value which will be exchanged. The brokers/ agents are aware of these rates based on comparable transactions carried out in the neighbourhood and an adjustment factor is incorporated for size, feasibility, irregularity, shape etc of the land/building, whereby either a premium or discount is given to the rates provided by the brokers and the final rate at which the property has to be valued at is arrived. The Valuers have satisfied themselves on the reasonableness of the values and the Company has relied on the expert opinion of the Valuers.

- i) Market rates obtained by the valuers from the brokers/agents for valuation of freehold land were not susceptible of verification with documentary evidence. As a result, reasonableness of the values adopted in the books of accounts could not be verified in Audit.
- ii) Lease hold properties included cancelled leases, non-existent lease agreements *ab initio* and expired lease agreements. The conditions stipulated by the lessor in the lease agreements had also not been fulfilled by the Company.

It may be pertinent to note that the Company is in the process of obtaining the title deeds to the properties. Further, the details of these properties have also been mentioned in the annexure attached to the scheme of amalgamation of Air India Ltd. and Indian Airlines Ltd.

Though the L&DO had cancelled the lease of the Vasant Vihar Property in 1983, the Company is paying the ground rent regularly (half yearly) which is being accepted without demur by the L&DO office. The Company has valued the property based on a



<p>iii) A reference is drawn to the paragraph 5(i) of the Statutory Auditors' Report which states that the fair value amounting to Rs. 51,295.10 million and consequential impact on Capital Reserve of immovable property at Vasant Vihar Housing Colony is subject to reinstatement of lease deed. The paragraph <i>ibid</i> is not explicative of the applicability of the standard clause in the lease agreements executed with the Land and Development Officer regarding sharing of 50 per cent of the unearned increase in value even if the lease deed is reinstated in favour of the Company.</p>	<p>legal opinion. Due disclosure has been provided in the accounts on this property.</p> <p>The existence assertion is satisfied by the fact that the Company has physical possession of these properties which are in continuous use. The fact that the Company has vacant and peaceful possession of these properties without any litigation is in itself a sufficient proof that a clear and marketable title exists in respect of these properties. The management would certainly pursue efforts with the authorities in order to get proper title deeds to these properties in due course of time. The valuation has been done strictly in accordance with the scheme of amalgamation which suggests that properties have to be reflected at "fair value" in the books of the transferee company.</p> <p>Stipulation of sharing 50 per cent of unearned amount on sale is not in the knowledge of the Company based on the available documents of possession and ownership. However, the scheme of conversion from lease hold to free hold by payment of nominal charges is also available in Delhi for L&amp;DO land. We are of the understanding that the Valuers have valued the property as lease hold land taking recognition of this principle whilst valuing the property.</p>
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