

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 2009.

The preparation of financial statements of **National Aviation Company of India Limited** for the year ended 31 March 2009 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 November 2009.

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 2009. 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 :

Balance Sheet

Sources of Funds

Reserve and Surplus

General Reserve : Rs. 633.5 million

The closing balance of General Reserve was arrived at after transfer of an amount of Rs.80,280.9 million from Capital Reserve which in the year 2007-08 was credited to that account (being excess of revaluation of immovable properties viz. land and buildings over the value of shares given to transferor companies as per the Scheme of Amalgamation approved by the Ministry of Corporate Affairs vide its order dated 22 August 2007). Consequently, accumulated losses of Rs.77,744.2 million up to 2008-09 (previous year-Rs.22261.6 million plus current year-Rs.55,482.6 million) have been adjusted. The leeway to carry out financial and capital restructuring and to improve the key financial ratios by transferring an amount of Rs.80,280.9 million during the current year from Capital Reserve to General Reserve was availed of by the Company in the context of a revised order dated 15 May 2009 of the Ministry of Corporate Affairs.

However, the above accounting treatment needs to be viewed in the light of the following :

- i) The Company, prior to transferring the amount of Rs.80,280.9 million from Capital Reserve to General Reserve in the current year, had not removed the limiting factors (cancelled leases, non-existence of lease agreements *ab initio* and expired leases) on its title to the leased properties causing impairment to the fair values of the properties. (*Comment No. D(ii) of the Comptroller and Auditor General of India on the accounts of Company for the period ended 31 March 2008 refers in this regard*).
- ii) The reasonableness of the values of freehold land adopted in the books of the Company could not be verified in Audit in the absence of documentary evidence for the market rates. The Company did not take into account the standard requirement of lessors (namely Land & Development Office, New Delhi and City & Industrial Development Corporation of Maharashtra, Navi Mumbai) as per which these lessors have a claim on 50 *per cent* of unearned increase in the value of leased lands given to the lessee. (*Comments No. D(i & iii) of the Comptroller and Auditor General of India on the accounts of Company for the period ended 31 March 2008 refer in this regard*).
- iii) Attention is also drawn to footnote No. 5 in Schedule F - Fixed Assets. Freehold and Leasehold lands included land of Rs.52,525.7 million for which registration deeds had not been executed in favour of the Company.

Thus, adjustment of accumulated losses against the revaluation reserve, an unrealized gain, which itself is affected by factors mentioned in para (i) to (iii) above, is not in accordance with the generally accepted accounting principles.

Investments : Rs.1,231.80 million (Schedule G)

The above incorrectly includes Rs.333.9 million paid towards advance to proposed joint venture AI-SATS which had not been incorporated. This has resulted in overstatement of Investment by Rs.333.9 million and understatement of Loans & Advances to that extent.

Current Assets, Loans & Advances Rs.57,507 million (Schedules H to L)

- (i) The above includes an amount of Rs.1,707.6 million paid to lessor towards maintenance charges which had been accounted for as Prepaid Expenses as per Company's Accounting Policy M(b). As the amount towards maintenance charges accrued on the basis of flight cycles / hours flown, the amount paid should have been treated as expenditure as per the accrual basis of

NACIL

accounting. Thus, the accounting treatment adopted by the Company resulted in overstatement of Prepaid Expenses and understatement of loss for the year by Rs.1,707.6 million. (*Comment No. B.2(i) of the Comptroller and Auditor General of India on the accounts of Company for the period ended 31 March 2008 refer in this regard*).

- (ii) The above includes Rs.1,019.9 million, depicted as recoverable from Airport Authority of India (AAI) on account of Ground Handling Arrangement. The Company in 1995 disputed the existing revenue sharing agreement with AAI in the ratio of 30:70 and proposed 50:50 sharing along with increase in the AAI's share of fixed cost from Rs.30 million to Rs.50 million respectively which had not been agreed to by the AAI. However the Company raised the claim in 2006-07 for the differential amount (20 *per cent*) and recognized revenue of Rs.1,019.9 million. As AAI had not accepted the proposed revision, the realisation of the said amount was uncertain and, thus, recognition thereof is not as per Accounting Standard 9. Therefore, provision for Rs.1,019.9 million should have been created. This has resulted in understatement of loss and overstatement of Loans and Advances by Rs.1,019.9 million.

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

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

Place : Mumbai
Date : 08 February 2010.

**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 MARCH 31, 2009.**

Sr. No.	Supplementary Audit Observations	Management Reply
01.	<p>SOURCES OF FUNDS RESERVE AND SURPLUS GENERAL RESERVE : RS.633.5 MILLION</p> <p>The closing balance of General Reserve was arrived at after transfer of an amount of Rs.80,280.9 million from Capital Reserve which in the year 2007-08 was credited to that account (being excess of revaluation of immovable properties viz. Land and Buildings over the value of the shares given to transferor companies as per the Scheme of Amalgamation approved by the Ministry of Corporate Affairs vide its order dated 22 August 2007). Consequently, accumulated losses of Rs.77,744.2 million up to 2008-09 (previous year Rs.22261.6 million plus current year – Rs.55,482.6 million) have been adjusted. The leeway to carry out financial and capital restructuring and to improve the key financial ratios by transferring an amount of Rs. 80,280.9 million during the current year from Capital Reserve to General Reserve was availed of by the Company in the context of a revised order dated 15 May 2009 of the Ministry of Corporate Affairs.</p> <p>However, the above accounting treatment needs to be viewed in the light of the following :</p> <p>i) The Company, prior to transferring the amount of Rs.80,280.9 million from Capital Reserve to General Reserve in the current year, had not removed the limiting factors (cancelled leases, non-existence of lease agreements <i>ab initio</i> and expired leases) on its title to the leased properties causing impairment to the fair values of the properties. (<i>Comment No. D(ii) of the Comptroller and Auditor General of India on the accounts of the Company for the period ended 31 March 2008 refers in this regard</i>).</p>	<p>i) The Company is in the process of rectifying the defect in the title deeds to the properties.</p> <p>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 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 marketable title exists in respect of these properties. The Management would certainly pursue efforts with the authorities in order to get reinstatement of the title deeds to the Vasant Vihar property in due course of time. The valuation has been done by a Government approved Valuer, 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>

Sr. No.	Supplementary Audit Observations	Management Reply
	<p>ii) The reasonableness of the values of freehold land adopted in the books of the Company could not be verified in Audit in the absence of documentary evidence for the market rates. The Company did not take into account the standard requirement of lessors (viz. Land & Development Office, New Delhi and City & Industrial Development Corporation of Maharashtra, Navi Mumbai) as per which these lessors have a claim on 50 per cent of unearned increase in the value of leased lands given to the lessee. <i>(Comments No. D (i & iii) of the Comptroller and Auditor General of India on the accounts of Company for the period ended 31 March 2008 refer in this regard).</i></p> <p>iii) Attention is also drawn to footnote No. 5 in Schedule F – Fixed Assets. Freehold and Leasehold lands included land of Rs.52,525.7 million for which registration deeds had not been executed in favour of the Company.</p> <p>Thus, adjustment of accumulated losses against the revaluation reserve, an unrealized gain, which itself is affected by factors mentioned in para (i) to (iii) above, is not in accordance with the generally accepted accounting principles.</p>	<p>ii) The methodology adopted by the valuer was based on fair market rates, which are 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.</p> <p>Stipulation of sharing 50% 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&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> <p>iii) As reflected in Schedule 'B' – Reserves and Surplus", the entire amount of Rs.80,280.9 million representing the excess of fair value over the shares transferred has been transferred from Capital Reserve to General Reserve.</p> <p>As regards Vasant Vihar property, the Management has already taken action to reinstate the lease deed at an appropriate level. It is submitted that continuous follow up action will be taken by the Management for the reinstatement of the lease deed. In view of this, refining the fair value of these immovable properties does not arise.</p> <p>The figure reflected in the footnote 5 of Schedule "F" Fixed Assets is Rs.52,525.7 million. Out of this amount, the major amount is towards Vasant Vihar property of Rs.51,295.1 million.</p> <p>The accounting treatment in the books of the Transferee Company has been prescribed under Clause 4.2 Part-III in the Scheme of Amalgamation. In accordance with clause 4.2, the difference being the excess of the value of the net assets of the Transferor Companies transferred to the Transferee Company over the value of the shares allotted by the Transferee Company shall be credited to General Reserve Account which shall be treated as free reserves and shall be available to the Transferee Company for such purposes as</p>

Sr. No.	Supplementary Audit Observations	Management Reply
		<p>Transferee Company at its own discretion considers proper including but not limited to declaration of dividends.</p> <p>Accordingly, the excess of fair value over shares transferred by virtue of this clause has been transferred to general reserve and the Company has adjusted the accumulated loss against the general reserve of the Company which comprises of this revaluation reserve.</p>
	<p>Investments : Rs.1,231.80 million (Schedule G)</p> <p>The above incorrectly includes Rs.333.9 million paid towards advance to proposed joint venture AI-SATs which had not been incorporated. This has resulted in overstatement of Investment by Rs.333.9 million and understatement of Loans & Advances to that extent.</p>	<p>Necessary disclosure for investment of NACIL in the proposed Joint Venture with Air India & SATS has been given in Schedule V – Notes to Accounts in Note No. 20C(b) of the Annual Accounts and therefore there is no overstatement or understatement.</p> <p>The approval for formation of JV with M/s. SATS has been received from the Government and necessary formalities will be completed for formation of a JV in the financial year 2010-11. The business activity has already commenced under the Air India / SATS Joint Venture under consortium arrangement. Contribution towards capital investment in the Joint Venture only has been reflected under Investments as the same cannot be shown under Current Assets, Loans and Advances.</p> <p>Accordingly, the share of contribution made by NACIL in the proposed JV with M/s. SATS is reflected under Trade Investments Schedule “G” Sr. No. 9 instead of reflecting the same under loans and advances.</p>
	<p>Current Assets, Loans & Advances Rs. 57,507 million (Schedules H to L) :</p> <p>i) The above includes an amount of Rs. 1707.6 million paid to lessor towards maintenance charges which had been accounted for as Prepaid Expenses as per Company’s Accounting Policy M(b). As the amount towards maintenance charges accrued on the basis of flight cycles/ hours flown, the amount paid should have been treated as expenditure as per the accrual basis of accounting. Thus, the accounting treatment adopted by the Company resulted in overstatement of Prepaid Expenses and understatement of loss for the year by Rs.1,707.6 million. <i>(Comment No. B 2(i) of the Comptroller and Auditor General of India on the accounts of Company for the period ended 31 March 2008 refer in this regard).</i></p>	<p>i) The accounting treatment was in accordance with the accounting Policy M – Schedule ‘U’, being consistently followed by the Company. The actual maintenance expenditure is charged in the year of maintenance event.</p> <p>Accordingly, maintenance contributions paid in advance to the lessors are accounted for as Prepaid Expenses and charged in the year of maintenance event.</p> <p>This will be charged off in the year 2009-10 and subsequent years based on the maintenance activity carried out on the aircraft and the drawal from the maintenance reserve.</p> <p>As such there has been no overstatement of Current Assets – Loans & Advances and understatement of maintenance expenses for the year 2008-09.</p>

Sr. No.	Supplementary Audit Observations	Management Reply
	<p>ii) The above includes Rs.1,019.9 million, depicted as recoverable from Airport Authority of India (AAI) on account of Ground Handling Arrangement. The Company in 1995 disputed the existing revenue sharing agreement with AAI in the ratio of 30:70 and proposed 50:50 sharing along with increase in the AAI's sharing of fixed cost from Rs.30 million to Rs.50 million respectively which had not been agreed to by the AAI. However, the Company raised the claim in 2006-07 for the differential amount (20 per cent) and recognized revenue of Rs.1,019.9 million. As AAI had not accepted the proposed revision, the realization of the said amount was uncertain and thus, recognition thereof is not as per Accounting Standard 9. Therefore, provision for Rs. 1,019.9 million should have been created. This has resulted in understatement of loss and overstatement of Loans and Advances by Rs.1,019.9 million.</p>	<p>ii) The amount of Rs.1019.9 million shown under this item relates to the amount computed as recoverable from AAI towards GHA which AI had with AAI from 4 May 1977 until 3 November 2002. During this period, the revenue sharing arrangements and annual fixed retention by AI underwent periodic changes until March 31, 1992 when AI shared the total revenue earnings with AAI at the Cargo Complex at Mumbai on a 70:30 basis, with AAI getting a 70% share. The sharing of revenue was computed upon an amount arrived at after deducting an amount of Rs. 30 million as fixed expenses of AI.</p> <p>After the aforesaid date, in view of the considerable increase in expenses of AI a meeting was held between AI and AAI on May 5, 1995 in which AAI agreed to put up AI's request to increase the fixed amount from Rs.30 million to Rs. 50 million per month and sharing the revenue on a 50:50 sharing basis with effect from April 1, 1995.</p> <p>Since there was no comeback from AAI on this issue, AI sought a high level meeting with AAI and met them on March 18, 2006 and again on May 17, 2006 to resolve this matter. AAI desired to have the complete revenue earning from this joint endeavour over the period under consideration and the same was personally handed over to AAI officials in the said meeting.</p> <p>Despite assurances during the said meetings, there has been no response from AAI on this and left with no choice, AI advised AAI of the amount due and raised an invoice of Rs. 1019.9 million on AAI in the year ending March 31, 2007 in respect of amount to be recovered for revenue sharing arrangement at Cargo Complex.</p> <p>Since there are outstanding amounts due to AAI, for various services availed of, from AAI, and billed by them to us such as variations in TSP charges difference from April 1994 to November 2002. The same has been retained as outstanding liability in the books of accounts, pending recovery of Rs.1019.9 million from AAI towards Ground Handling Agreement. Since the recoverable amount would be adjusted from the amount payable, which is higher than the recoverable amount, the question of provision for doubtful debts does not arise.</p>