Common Errors in Financial Reporting & Audit Report

"Always try to learn from other people's mistakes, not your own- it is much cheaper that way"

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Chhajed & Doshi
CHARTERED ACCOUNTANTS

Applicability of Accounting Standards

Applicability of Accounting Standards

Are Accounting Standards applicable to Non-corporates?

Where should non-compliances of Accounting Standards be reported?

Applicability of Accounting Standards

- Entities that are to follow AS
  - Companies
    - Companies (Accounting Standards), Rule, 2006
    - Ind AS
    - ICDS
  - Other than Companies
    - AS issued by ICAI
    - ICDS

Applicability of Accounting Standards

➢ AS applicable to Non-Corporates:

- This scheme is made effective in respect of accounting periods commencing on or after April 1, 2020.
- Under this amendment, i.e. w.e.f. April 1, 2020, there is an introduction to level 4 entity.

Level	Turnover (Rs)	Borrowings (Rs)
I (Large)	>250 Cr	>50 Cr
II (Medium)	>50 Cr - < 250 Cr	>10 Cr - < 50Cr
III (Small)	>10 Cr - < 50 Cr	>2 Cr - < 10 Cr
IV (Micro)	<10 Cr	<2 Cr

Disclosure: Non-Corporate

"The entity is a micro small and medium sized enterprise (MSME) as per the announcement made by the ICAI and has complied with the accounting standards in so far as they are applicable to the entities falling in level II or Level III or Level IV, as the case maybe."

Two year wait period if change is from Level I to II or III or IV

Applicability of Accounting Standards

- AS applicability for Companies

Conditions	SMC (Rs)	Other than SMC (Rs)
Turnover (excluding other Income) in P Y	< 250 Cr	> 250 Cr
Borrowing (including public deposit)	< 50 Cr	> 50 Cr

Disclosure – Corporate

“The Company is a Small and Medium Sized Company (SMC)as defined in the Companies (Accounting Standard) Rules, 2021 notified under the Companies Act, 2013. Accordingly, the Company has complied with the Accounting Standards as applicable to a Small and Medium Sized Company.”

Two year wait period if change is non-SMC to SMC

Points to remember: Audit Report

Points to remember: Audit Report

EOM vs OM

The purpose of auditor's report is to convey **primarily the auditor's opinion** on financial statements but if auditor believes that there is a **matter that must be brought to attention** of user of financial statements then he may do so by adding either or both of additional paragraphs called emphasis of matter (EOM) and other matter (OM) paragraph.

➢ *What's the difference between Emphasis of Matter and Other Matter?*

Auditor may add an Emphasis of Matter para for **emphasizing a matter already adequately disclosed** in financial statements.

Other matter para is pertaining to **matter other then those presented or disclosed** in the financial statements and in auditor's judgement it is necessary to bring that to user's attention by giving necessary details.

Points to remember: Audit Report

EOM vs OM

- *Can we add Emphasis of Matter as well as Other Matter?*
  Yes, **both paras can be added** in a single audit report.

- *Can I use EOM or OM para in substitution of a qualified opinion?*
  Inclusion of emphasis of matter or other matter paragraphs in a report with unmodified opinion **does not qualify the opinion** i.e. inclusion of any or both will not result in modification of auditor's opinion. However, these paragraphs **can be used even if opinion is modified**.

- *Where should EOM or OM para be placed?*
  These paragraphs are included **after opinion paragraph** in the auditor's report. Other matter para should be added subsequent to Emphasis of Matter para in case both paras are being added. Other Matter paragraph may even be included as a separate section following the Report on the Financial Statements and the **Report on Other Legal and Regulatory Requirements depending on the relevance** to that section of audit report.

Points to remember: Audit Report

EOM vs OM

Some points to remember:-

- An other matter para should be added if **comparative period figures** not audited by us. Eg: '*The financial statements of the Company for the year ended ________, were audited by another auditor who expressed an unmodified opinion on those statements on ________.*
- An other matter para should be added in consolidated auditor's report in case a subsidiary/joint venture/associate has been consolidated based on **figures certified by management** or even branch in case of standalone financial statements.
- An other matter para should be added in consolidated auditor's report in case a subsidiary/joint venture/associate has been consolidated based on **figures audited by another auditor** or even branch in case of standalone financial statements.
- Figures stated in the other matter para of consolidated auditors' report should be cumulation of figures of standalone financial statements of respective components.

Points to remember: Audit Report

Information Other than the Financial Statements and Auditor's Report Thereon

Some points to remember:-

- Auditor's report should also include a section 'Other Information' which deals with Auditor's Responsibilities Relating to Other Information. Other information includes financial or non-financial information (other than financial statements and the auditor's report thereon) included in an entity's annual report.

Our **responsibility** is to **read the other information** identified above **when it becomes available** and, in doing so, **consider whether** the other information is **materially inconsistent** with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.	In case the other information is **not available at the time of signing** audit report, the auditor should communicate the fact.	*Eg: 'As on date, the Director's Report is **under preparation**. When we read the same and **if we conclude** that there is any **material misstatement** therein, we will **communicate** the matter to those charged with governance.'*
	In case the other information is **available at the time of signing** audit report and nothing is materially inconsistent	*Eg: 'We have **nothing to report** in this regard'*

Points to remember: Audit Report

Revisions made to Audit Report in Recent Years

Ultimate Beneficiaries clause

*a) The management has **represented** that, to the best of its knowledge and belief, **no funds** have been **advanced** or **loaned** or **invested** (either from borrowed funds or share premium or any other sources or kind of funds) by the Company **to or in any other person or entity**, including foreign entity ("Intermediaries"), with the **understanding**, whether recorded in **writing or otherwise**, that the Intermediary shall, whether, directly or indirectly **lend or invest in other persons or entities** identified in any manner whatsoever by or on behalf of the Company ("Ultimate Beneficiaries") **or provide any guarantee, security or the like** on behalf of the Ultimate Beneficiaries;*

*(b) The management has **represented**, that, to the best of its knowledge and belief, **no funds** have been **received** by the Company **from any person or entity**, including foreign entity ("Funding Parties"), with the **understanding**, whether recorded in **writing or otherwise**, that the Company shall, whether, directly or indirectly, **lend or invest in other persons or entities** identified in any manner whatsoever by or on behalf of the Funding Party ("Ultimate Beneficiaries") **or provide any guarantee, security or the like** on behalf of the Ultimate Beneficiaries; and*

*(c) In our opinion and based on the audit procedures, we have considered reasonable and appropriate in the circumstances; **nothing has come to our notice that has caused us to believe** that the representations under sub-clause (a) and (b) contain any material misstatement.*

Points to remember: Audit Report

Revisions made to Audit Report in Recent Years

Dividend Payment clauses

a) *The Company has **neither declared nor paid** any dividend during the year.*

b) *The final dividend **proposed in the previous year**, declared and paid by the Company during the year is in accordance with Section 123 of the Act, as applicable.*

c) *The interim dividend **declared and paid by the Company during the year** and **until the date of this report** is in compliance with Section 123 of the Act.*

d) *As stated in Note ___ to the Standalone Financial Statements, the Board of Directors of the Company has **proposed final dividend for the year** which is subject to the approval of the members at the ensuing Annual General Meeting. The amount of dividend proposed is in accordance with Section 123 of the Act, as applicable.*

Points to remember: Audit Report

Revisions made to Audit Report in Recent Years

Dividend Payment clauses (Sec 123 of Companies Act, 2013)

- Sources of dividend
  - Current year's profit of the Company
  - Undistributed or accumulated profits of the previous year
    - In accordance with Rule 3 of Companies (Declaration and Payment of Dividend) Rule, 2014
      - Rate of dividend shall not exceed average of the rates declared in immediately 3 preceding FYs
      - Total amount shall not exceed 1/10th of paid up share capital + free reserves
      - Balance of reserves after such withdrawal shall not fall below 15% of paid up share capital

Points to remember: Audit Report

Revisions made to Audit Report in Recent Years

<u>Audit Trail clause</u>

Proviso to Rule 3(1) of Companies (Accounts) Rule, 2014 for maintaining books of account using accounting software which has a feature of recording audit trail (edit log) facility is applicable to the Company with effect from April 1, 2023, and accordingly, reporting under Rule 11(g) of Companies (Audit and Auditors) Rules, 2014 is not applicable for the financial year ended 31st March 2023.

Amendments in Companies (Accounts) Rules, 2014

- Software has a feature of recording audit trail (edit log) facility
- Audit trail feature cannot be disabled

Points to remember: Audit Report

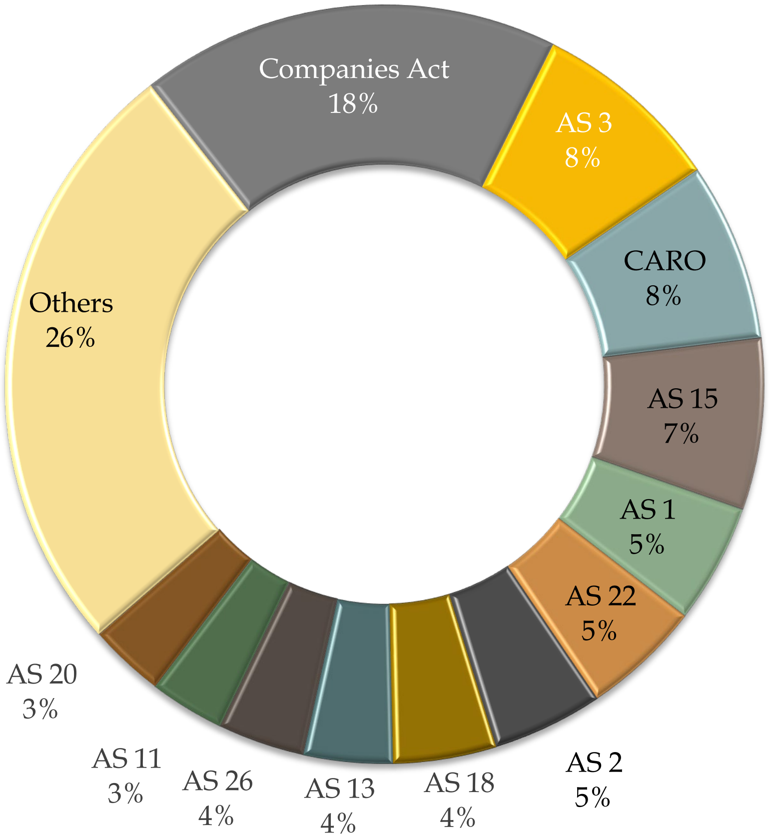
General Points

In some Companies, following was observed in the audit report:-

- Emphasis of Matter was stated as Other Matter or vice versa
- Other Information paragraph was **missing**
- Revisions made to audit reports in recent years were not considered
- Language used in Audit report was **inconsistent with the language** given in SA 700
- All points of **Other Legal and Regulatory Matters** were not covered
- **Referencing to notes** in Audit Report was incorrect
- IGAAP and IndAS used interchangeably

Common Errors in Financial Reporting

Common Errors in Accounting Standards



Chhajed & Doshi
CHARTERED ACCOUNTANTS

Common Errors in Accounting Standards

AS 1: Disclosure of Accounting Policies

Observations

Some companies fail to provide information about **significant accounting policies** related to the following:

- Valuation of Inventories
- Accounting for Investments
- Employee Benefits
- Borrowing Costs
- Segment Reporting
- Accounting for taxes on income
- Impairment of Assets
- Provisions, Contingent liabilities and Contingent Assets

Accurate representation

Companies in general might have taken loans, held inventories, made investments, employed personnel, paid income taxes, and owned assets that could potentially experience a decrease in value. According to Para 24 of AS 1, all significant accounting policies adopted in preparing and displaying financial statements must be disclosed.

Common Errors in Accounting Standards

AS 2: Valuation of Inventories

Observations

Accounting policy regarding Valuation of Inventory of several Companies stated that

'Inventory (i.e. Raw Materials, Work in Progress, Finished Goods, etc.) has been valued at Cost'.
or
'Inventory is valued at FIFO/LIFO/Weighted Average'

Accurate representation

In some Companies, the concept of **'net realizable value'** was not taken into account for valuation of inventories.

Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and the estimated costs necessary to make the sale.

In some cases, although the valuation policy adopted has been disclosed, the **cost formula** adopted for determining the cost has not been disclosed. Also, an accurate presentation would be disclosing which cost formula has been used for which class of inventories.

Common Errors in Accounting Standards

AS 2: Valuation of Inventories

Observations

Further, Accounting policy regarding Valuation of Inventory of several Companies stated that

'Inventories are valued at cost or market value whichever is lower'

or

'Finished goods - valued at cost or market price, whichever is lower'

Accurate representation

It was observed from the accounting policies disclosed by these companies for inventory valuation that the inventories have been valued at the lower of cost and **market value, rather than considering the net realizable value**.

Therefore, it seems that the projected expenses for completion and the anticipated costs required for making a sale have not been subtracted from the projected selling price when determining the valuation of inventory.

Common Errors in Accounting Standards

AS 2: Valuation of Inventories

Observations

In some annual reports, it was observed that

'Work in Progress at raw material cost'
or
'Cost of finished goods and work in progress are determined on estimated cost basis'

Accurate representation

Firstly, in case of Work in Progress, the **conversion cost** should also be considered.

Secondly, it should also be clear from accounting policies whether all applicable costs have been considered or not. Words like '**directly attributable costs**' may be included in the accounting policy.

Common Errors in Accounting Standards

AS 2: Valuation of Inventories

Observations

In some annual reports, it was noted that the inventories have been described as **taken, valued and certified by the director/management**.

In some cases, it was stated that, 'Finished goods are valued at lower of cost or **net realisable value as certified by the management**'

Accurate representation

ICAI vide Guidance Note on 'Audit of Inventories' clarified that the expression '**taken, valued and certified by the director/management**' may result in users of financial statements in believing that the auditors have **merely relied on management** without carrying out appropriate audit procedures.

Further, it was clarified that the **auditor's responsibilities shall not be diminished** even if such statement is made. Therefore, the client should be advised to refrain from making such statements in financial statements.

Common Errors in Accounting Standards

AS 3: Cash Flow Statements

Observations

From the Statement of Profit and Loss and the Cash Flow Statement of a company read with the notes to the accounts, it was noted that Net profit for the year is inclusive of unrealized exchange rate difference, interest and dividend income.

Accurate representation

Para 30 of AS 3 states that **Cash flow from interest and dividends received and paid** should be **disclosed separately**. In case of **financial enterprises**, it will be classified as **operating activity** whereas in case of **other entities** it will be classified as **investing activity**.

Dividend **paid** should always be classified as financing activity.

Common Errors in Accounting Standards

AS 3: Cash Flow Statements

Observations

Accurate representation

From the Cash Flow Statement given in the Annual Report of a company it has been noted that movement in unsecured loans, deposits/advances, borrowing and investment was disclosed on net basis.

Para 21 of AS 3 states that an enterprise should **report separately major classes** of gross cash receipts and gross cash payments arising from investing and financing activities, except

- cash receipts and payments on behalf of customers
- cash receipts and payments for items in which the **turnover is quick**, the **amounts are large**, and the **maturities are short**
- Acceptance/repayment of deposit or advancing/repayment of loan **in case of financial entity**

Common Errors in Accounting Standards

AS 3: Cash Flow Statements

Observations

Accurate representation

In case of some Companies it was observed that Cash and cash equivalents balances included 'margin money', 'unpaid dividend account', 'fixed deposit under lien' and 'earmarked balances against gratuity'.

An entity should **disclose**, the amount of significant cash and cash equivalent **balances that are not readily available** for use by it.

Common Errors in Accounting Standards

AS 3: Cash Flow Statements

Observations

In case of some Companies, it was observed that **Cash and Bank balances as per Balance Sheet** was in **agreement** with the **Cash and cash equivalent balance in the cash flow statements** which also included deposits with maturity of more than 3 months.

Accurate representation

Deposits with original maturity of 3 months or less should be considered as cash and cash equivalents and remaining deposits should be classified as other bank balances. However, deposits with maturity of more than 12 months remaining, shall be classified as other non-current assets.

Therefore, deposits with maturity of more than 3 months should not be included in cash and cash equivalents balance.

Common Errors in Accounting Standards

AS 4: Contingencies and Events Occurring After the Balance Sheet Date

Observations

In case of some Companies, the following note was appearing:

'Cheques received from XYZ Marketing Services Pvt. Ltd. were dishonored during the year. The company has initiated legal proceedings against the said party u/s 138 of the Negotiable Instruments Act. The management is confident of recovery of the dues and hence no provision is required'

Accurate representation

A contingent liability should be disclosed along with its **nature** and an **estimate** of its financial effect unless the possibility of a loss is remote. If a reliable estimate of the financial effect cannot be made, this fact should be disclosed.

In the given case, it was observed that **although the nature of contingent liability has been disclosed, the financial effect of the same has not been disclosed.**

Common Errors in Accounting Standards

AS 5: Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies

Observations

In case of some companies, it was observed that certain incomes or expenses were directly credited or debited to the reserves and surplus rather than being routed through profit and loss account. Some of these items included short provision for bonus, provision for income tax relating to earlier years, investments written off, etc.

Accurate representation

Para 5 of AS 5 clearly states that all the items of incomes and expenses which are recognised in a period should be **routed through profit and loss** for that particular period.

If any of the expenses are a result of an **error or omission** in the preparation of financial statements of prior periods, it should be **disclosed as a prior period income or expense**.

Common Errors in Accounting Standards

AS 5: Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies

Observations	Accurate representation
In case of some companies, it was observed that prior period incomes or expenses were clubbed along with their respective income heads or expense heads.	**Para 15 of AS 5** clearly states that prior period incomes or expenses should be **separately disclosed** in the financial statements such that their impact on the current years profit or loss can be perceived.

Common Errors in Accounting Standards

AS 9: Revenue Recognition

Observations

With regards to revenue recognition, following was observed in case of some companies:

1. Revenue from sale of tickets for a particular event was booked on sale of such tickets.
2. Revenue in case of subscription of an OTT platform was booked when the customer purchased the subscription.

Accurate representation

In case of transactions involving services, revenue should be recorded either under the **completed service contract method** or under the **proportionate completion method**. In the given cases,

1. Revenue from sale of tickets should be recognised as per the completed contract method i.e. when the event takes place.
2. Revenue in case of subscription for an OTT platform should be recognised as per the proportionate completion method i.e. over the period of time.

Common Errors in Accounting Standards

AS 9: Revenue Recognition

Observations

With regards to revenue recognition in cases where goods are involved, it was noted that accounting policies of various companies stated that revenue in case of goods is recognised when the significant risk and rewards are transferred. However, in reality it was observed that sales cut off procedures were not followed.

Accurate representation

Revenue in case of goods should be recognised on transfer of **significant risk and rewards**. Proper **sales cut off procedures** should be followed. Each **customer contract** should be studied for making a decision on when significant risk and rewards were transferred.

In some cases, risk and rewards are transferred when the goods leave the factory compound i.e. Ex-factory basis. However, in some cases the risk and rewards are not transferred until the goods reaches the customer. Revenue should be recognised only after consideration of these customer contracts.

Common Errors in Accounting Standards

AS 9: Revenue Recognition

Observations

It was noted that a Company recognised as income the entire cost of garments destroyed by fire under other operating income (stock loss claim) based on filing of insurance claim.

With regard to partially damaged stocks, the related inventory was valued at NRV and insurance claim against the same was taken as other income. Insurance claim against loss of fixed assets was also recognised based on the claim filed with the insurance company. The note further states said income has been recognised as per the AS 9.

Accurate representation

Firstly, it should be noted that insurance claims do not fall under the purview of AS 9 since it is not covered under the definition of revenue.

However, it was viewed that recognising insurance claims also requires that the **amount is measurable** and it is **not unreasonable to expect** the ultimate collection. In such cases, revenue recognition should be postponed until the claims are accepted / sanctioned by the insurance company.

Common Errors in Accounting Standards

AS 9: Revenue Recognition

Observations

The accounting policies regarding recognition of dividend income has been disclosed as follows in the Annual Reports of some companies:

- Dividend is accounted as and when received.
- Income & Expenditures are recognised on accrual basis except dividend on shares and units of Mutual Funds, which are recognised on cash basis

Accurate representation

In these cases, it was observed that dividend income has been recognised on receipt basis whereas AS 9 requires dividend income to be recognised when the **right to receive payment has been established**.

Common Errors in Accounting Standards

AS 9: Revenue Recognition

Observations

Following was observed in the Annual Reports of some companies:

- In the note of sales, gross sales figure has been shown from which 'Duties and Taxes' have been shown as a deduction.
- Accounting policy on Revenue Recognition stated 'Revenue from operations includes sale of goods, services, goods and service tax and gain/loss on corresponding hedge contract'

Accurate representation

In accordance with the definition of revenue as per Guidance Note on Terms Used in Financial Statements, **no taxes and duties should be included in sales**.

Further it was noted from the policy of the last case, that gain or loss on corresponding hedge contracts was also included in revenue from operations. However, the sales transaction and the hedge contract are **two independent transactions**. Accordingly, adjusting gain or loss on hedging contracts against revenue is also not in line with AS 9.

Common Errors in Accounting Standards

AS 10: Property, Plant and Equipment

Observations

In various cases, it is assumed that land has unlimited useful life and therefore, it is not depreciated.

Accurate representation

If the cost of land includes the costs of site dismantlement, removal and restoration, that **portion of the land** asset should be depreciated over the period of benefits obtained by incurring those costs.

Also in some cases, the **land** itself may have a **limited useful life** (for example, **leasehold land**). In such cases it should be depreciated in a manner that reflects the benefits to be derived from it.

Common Errors in Accounting Standards

AS 10: Property, Plant and Equipment

Observations

In one annual report, the following note appeared regarding PPE:

'Land and Buildings at certain locations were re-valued on 1st October, 1982. Gross depreciation for the year includes depreciation on revalued assets of Rs. Xxx charged against Revaluation Reserve.'

Accurate representation

AS 10 requires that if an item of property, plant and equipment is revalued, the **entire class of property, plant and equipment** to which that asset belongs should be **revalued**.

Further, in some cases it was observed that depreciation on revalued portion of an asset was not routed through the revaluation reserve.

Common Errors in Accounting Standards

AS 10: Property, Plant and Equipment

Observations

From the accounting policy of a company, it was noted that the property, plant and equipments are capitalised when they are **put to use**.

Accurate representation

Depreciation of an asset begins when it is **available for use**, i.e., when it is in the location and condition necessary for it to be capable of operating **in the manner intended by management**.

The concept of put to use is as per the Income Tax Act, whereas as per the accounting standards, an asset should be capitalised when it is **ready for use**.

Common Errors in Accounting Standards

AS 11: The Effects of Changes in Foreign Exchange Rates

Observations	Accurate representation
It was observed in some cases that the export sales have been recorded at the rate notified by the customs for invoice purposes.	In case of export sales, the exchange rate considered should be the **rate prevailing on the date of transaction** and **not the customs rate** which is notified fortnightly. Fluctuation from the rate prevailing on the date of transaction shall be included in Foreign Exchange Gain/Loss.

Common Errors in Accounting Standards

AS 13: Accounting for Investments

Observations

Following was stated in some companies:

- Long-term investments are carried at cost. No provision is being made for diminution in the value of investments as they are long-term investments.
- Long-term investments are stated at cost less provision, if any, for permanent diminution in value.

Accurate representation

Long term investments should be **carried at cost** in the financial statements. However, provision for diminution shall be made to recognise the **decline, other than temporary**, in the value of such investments.

It was observed in some cases that even though the investee company had eroded net worth and no major plans for revival, they were not provided for.

Further, it was viewed that there is a difference between 'permanent diminution' and 'other than temporary diminution'.

Common Errors in Accounting Standards

AS 15: Employee Benefits

Observations	Accurate representation
It was observed in some Companies, no provision for gratuity has been made on the pretext that none of the employees have completed five years.	According to a clarification issued by ICAI, provision for gratuity should be created irrespective of the fact as to whether 5 years have completed or not. Although there is a possibility that the benefit may not vest, there is also a probability that the employee would serve for the minimum period of five years and become eligible for gratuity. An **obligation exists even if a benefit is not vested**.

Common Errors in Accounting Standards

AS 16: Borrowing Costs

Observations

Accounting policy on Valuation of Inventories states–

*'Finished goods are valued at lower of cost or net realizable value; cost includes depreciation, **interest** (excluding interest on discounting of bills) and direct expenses to the point of stocking, excise duty but excludes administration and selling expenses.'*

Accurate representation

It was observed that interest costs were incorporated into the inventory's cost. It is generally understood that interest and other borrowing expenses are **not typically associated with bringing inventories to their current state and location**. Consequently, these costs are **usually not factored** into the calculation of inventory costs.

No borrowing cost (interest) can be capitalized **unless such inventories take a substantial period of time to get ready for sale**.

Common Errors in Accounting Standards

AS 16: Borrowing Costs

Observations

Accounting policy on Borrowing Costs in case of some Companies–

*'Borrowing costs directly attributable to the acquisition or construction of qualifying assets are capitalized as part of the cost of the assets up to the date the assets are **put to use**. Other borrowing costs are charged to the Statement of Profit & Loss in the year in which they are incurred.'*

Accurate representation

Capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete i.e. the asset is **ready for its intended use**.

Common Errors in Accounting Standards

AS 16: Borrowing Costs

Observations

Some companies are found to be treating debt restructuring charges/external commercial borrowings upfront fees as follows:

‘Restructuring charges which had been paid to extinguish high-cost debts were written-off over the tenure of fresh loans taken for refinancing such high cost debts.’

Accurate representation

It was noted that debt restructuring charges paid to extinguish high cost debts were **not incurred for the acquisition, construction or production of qualifying assets**. Therefore, such costs are not eligible for capitalization with the cost of asset.

It involves revision in the terms of borrowings. It was also viewed that, in any case, AS 16 does not prescribe amortization of such costs.

Common Errors in Accounting Standards

AS 18: Related Party Disclosures

Observations

The following transactions were noted from Notes to Accounts, Cash Flow Statement, Director's Report, Corporate Governance Report given of different companies but not in Related Party Disclosures:

- Advances given to directors;
- Application money received from KMP for preferential allotment;
- Equity shares allotted to KMP on conversion of warrants;
- Dividend paid to the holding company;
- Loans and advances given to as well as repaid by the subsidiary;

Accurate representation

It was viewed that all these transactions are in the nature of related party transactions and although these transactions have been reported in various parts of the Annual Reports, no disclosure has been made under Related Party Disclosures.

Details in other parts of financial statements cannot act as a substitute of Related Party Disclosures.

Common Errors in Accounting Standards

AS 18: Related Party Disclosures

Observations	**Accurate representation**
In some Companies, it was observed names of only those related parties was disclosed with whom transactions have taken place during the financial year or previous financial year.	**Name** of the related party and **nature** of the related party relationship **where control exists** should be disclosed irrespective of whether or not there have been transactions between the related parties.

Common Errors in Accounting Standards

AS 19: Leases

Observations

A Company had entered into non-cancellable lease for a period of 6 years and the rentals agreed were 20,000 for the first year and an increment of Rs. 2,000 each year.

The amount of expense recognized by the Company was equivalent to the amount of cash outflow

Accurate representation

The approach followed by the company in the given case was incorrect. In case of a non-cancellable lease agreement entered, where also includes an incremental clause for lease rentals, **Lease equalisation reserve** should be created.

In the given case, the amount of rental expense that should have been recognised every year should be ₹25,000, i.e. (20,000 + 22,000 + 24,000 + 26,000 + 28,000 + 30,000) / 6.

Common Errors in Accounting Standards

AS 20: Earnings Per Share

Observations

From the Annual Report of company, it was noted that basic and diluted earnings per share has not been disclosed on the face of Statement of Profit & Loss. However, the basic as well as the diluted earnings per share were disclosed in the Notes to Accounts and the Diluted EPS has been reported as 'Not Applicable'.

Accurate representation

As per the requirements of para 8 of AS 20, Basic as well as Diluted earnings per share should be **disclosed on the face of the profit and loss account**, even though the information relating to the same has been disclosed in the notes to accounts.

Diluted EPS under no circumstances can be not applicable. In case there are no potential equity shares, it would be the same as Basic EPS.

Common Errors in Accounting Standards

AS 21: Consolidated Financial Statements

Observations

In the Consolidated Financial Statements of a company, the following note was appearing:

'Most of the accounting policies of the reporting company and that of its subsidiaries are similar and are in line with generally accepted accounting principles in India. However since certain subsidiaries are in the business lines which are distinct from that of the reporting company and function in a different regulatory environment, certain policies in respect of investments, gratuity, depreciation/ amortisation etc. differ.'

Accurate representation

For the purpose of preparing consolidated financial statements, the accounting policies followed by the subsidiary companies or associate companies or joint ventures **should be in agreement with the accounting policies followed by the holding company**.

In case there is a difference in the accounting policies followed by the subsidiary company or associate company or joint venture, an **adjustment to that effect** should be given to the numbers of subsidiary while preparing the consolidated financial statements.

Common Errors in Accounting Standards

AS 22: Accounting for Taxes on Income

Observations

In the Annual Report of a Company, Net Deferred Tax Liabilities/ (Assets) was disclosed in Balance Sheet as follows:

Deferred Tax Assets
On accounts of Provision for contingency

Deferred Tax Liability
On accounts of depreciation
On accounts of others

Accurate representation

It was observed from the Schedule of Net Deferred Tax Liabilities/ (Assets) that although a significant amount had been recognised as the deferred tax liabilities 'on account of others', however, the nature of such 'other' was not disclosed.

Common Errors in Accounting Standards

AS 22: Accounting for Taxes on Income

Observations	Accurate representation
In the Balance Sheet of a company, both deferred tax assets and deferred tax liabilities have been shown separately on the face of the balance sheet.	An enterprise should **offset deferred tax assets and deferred tax liabilities if**: (a) the enterprise has a **legally enforceable right to set off** assets against liabilities representing current tax; and (b) the deferred tax assets and the deferred tax liabilities relate to taxes on income **levied by the same governing laws**.

Common Errors in Accounting Standards

AS 22: Accounting for Taxes on Income

Observations

In the accounting policy of a Company, following was noted:

'The deferred tax for the timing differences is measured using the tax rates and tax laws that have been enacted or substantially enacted at the Balance Sheet date. Deferred tax assets arising from the timing differences are recognized only on the consideration of prudence.'

Accurate representation

It has been noted from para 15 of AS 22 that deferred tax assets should be recognized and carried forward only to the extent that there is a **reasonable certainty** that **sufficient future taxable income will be available** against which such deferred tax assets can be realized. It has been noted that although the deferred tax asset has been recognized, however, it is not clear as to whether there exists reasonable certainty that sufficient future taxable income would be available against which such deferred tax assets could be realized.

Common Errors in Accounting Standards

AS 26: Intangible Assets

Observations

From the accounting policy on 'Deferred Revenue Expenditure' given in the Annual Report of a company it was noted that **expenditure incurred on factory license fees, trade mark fee, seed marketing expenses, public /capital issue expenses, preliminary expenses and rental paid for pre-commencement of retail stores, factories has been treated as deferred revenue expenditure** which are being amortized over the life of the concerned items.

Accurate representation

All the expenditures incurred on pre-commencement cannot be considered to be a **'resource' being controlled by the enterprise** and hence, such expenses do not meet criteria of term 'asset'.

With regard to software development expense and product development expense, it was viewed that **if it meets the definition of asset** as stated in paragraph 6.2 of AS 26, the same should also be recognised as an 'intangible asset'.

Common Errors in Accounting Standards

AS 29: Provisions, Contingent Liabilities and Contingent Assets

Observations

From the Annual Report of a company, it has been noted from accounting policy on Revenue Recognition that no provision has been made for possible returns or expenses during the warranty period.

Accurate representation

It was noted that obligation in respect of **sales return can be estimated** reliably on the basis of **past experience** and other relevant factors and a **provision in respect of sales returns** should be recognised; otherwise, the company should postpone the recognition of revenue on such sales.

Common Errors in Accounting Standards

AS 29: Provisions, Contingent Liabilities and Contingent Assets

Observations

In the Annual Report of company, it was noted from notes to accounts relating to 'Long-term Provisions' and 'Short-term Provisions ' that 'Provision for Expenses' has been included under these heads.

Accurate representation

As per para 12 of AS 29, provisions are made for **those liabilities**, the **measurement of which involves substantial degree of estimation** and which will be **settled in future**.

Expenses are generally considered as accrued against services that have been received but not settled. Therefore, it was viewed that the disclosure of unpaid expenses under the head of provisions is not in accordance with paragraph 12 of AS 29.

Common Errors in Accounting Standards

AS 29: Provisions, Contingent Liabilities and Contingent Assets

Observations

It was noted in the Annual Report in the Contingent Liability section of a Company:

'The Company has so far exported XXX MT of white sugar The Company is hopeful of fulfilling its balance export obligations. In the unlikely event of not fulfilling the export obligation, the Company has to pay the amount of duty concession availed in respect of its imports along with interest.'

Accurate representation

While disclosing details of any contingent liablity, an **estimate of its financial effect** should be given **unless it is not practical** to do so. In the **latter case, the fact should be accordingly disclosed**.

Other Common Errors

- **Name** of the entity mentioned is incorrect. *(Always verify the same from Statutory records)*

- **Note reference and amounts** between the Financial Statements and the notes to the Financial Statements are incorrect

- **Movement** related impacts are not correct (Deferred taxes, provisions, etc.)

- Totals in the Financial Statements, Schedules to the financial statements and Notes to the Financial Statements have **casting errors**

- **Incorrect interpretation** of CSR Expenditure in a financial year (*Intermediary should spend the money in the same financial year*)

- Final draft of the Financial Statements and auditors' report have **grammatical errors** or inconsistencies. (*Run spell check before final print*)

Ensure the final draft in the Financial Statements along with Auditors' report is read by a Partner independent of the audit to identify deficiencies, inconsistencies and the appropriateness of the disclosures.

Common Errors w.r.t. Companies Act

Common Errors w.r.t. Companies Act

Schedule II of Companies Act, 2013

- While comparing the lives estimated by management vis-a-vis lives indicated under Schedule II to Companies Act, 2013, it was noted that in certain cases the **lives estimated by management are different from the lives prescribed** under Schedule II.

- Company should disclose the lives used for depreciation of those assets, which is different from the lives prescribed under Schedule II and it should be supported by technical evaluation/ advice.

- Some companies which have multiple shifts of employees were found not to be adhering to the increased rates of depreciation (i.e. 150% in case of double shift and 200% in case of triple shift).

- **Intangibles not depreciated** cause no life prescribed in Schedule II - Error

Common Errors w.r.t. Companies Act

Schedule III of Companies Act, 2013

- Not disclosed rights, preference and restrictions with respect to each class shares
- Only final amount at end of year were reflected, without disclosing **movement during the year** in case of share capital.
- Debit balance of Reserves and Surplus was reflected on Assets side of the Balance Sheet instead of showing as a negative figure under the head Equity

Common Errors w.r.t. Companies Act

Schedule III of Companies Act, 2013

- Current Maturities of Long Term Borrowings were reflected as 'Other current liabilities' instead of disclosing under head 'Short term borrowings'.

- Classification of Loan as a non-current liability in PY, which on becoming a current liability during the current financial year, it re-classified the loan as current for PY too. If there is a **change in classification during subsequent year, the previous year position would not change**.

- In case of loans given by an entity other than financial enterprise to another Company, interest not charged on such loans is violation of Section 186(7).

Common Errors w.r.t. Companies Act

Schedule III of Companies Act, 2013

- It was observed that Trade Payables includes dues payable in respect of statutory obligations like PF, dues towards purchase of fixed assets and other contractual obligations. Payable which is in respect of **amount due towards goods purchased or services received in the ordinary course of business**, shall be classified as Trade Payable. Other payables as in the given case cannot form part of Trade Payables, but would be classified as "Other Current/ Non-Current Liabilities".

- A Company having Tangible & Intangible assets did not categorize the same separately. Similarly, separate disclosure is required for Capital Work in Progress, and Intangible Assets under Development.

Common Errors w.r.t. Companies Act

Schedule III of Companies Act, 2013

- Investment in Partnership Firms included investment in LLPs. LLP is a body corporate and not a partnership firm. Hence, **disclosures of investment in Partnership Firms would not include investment in LLPs**.

- Trading goods included in Finished goods is incorrect.

- Disclose Goods in transit i.e. Raw Materials in transit / Finished Goods in transit separately

- Trade Receivables outstanding for more than six months were wrongly considered from the date of invoice. **Ageing for the same should be from the due date of payment**.

- Trade Receivables wrongly included receivables due from sale of Property, plant and equipments and Investments – should be others.

THANK YOU

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