

J.B. NAGAR CPE Study Circle of WIRC of ICAI

Corporate Audit – Reporting Pitfalls

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Session Coverage

Common errors in FS

Errors in disclosure of Accounting Standards (FRRB publications)

Wrong reporting in CARO

Internal Financial Control Report – When can it be a clean report?

Non- adherence to ICAI Guidance

GST Perspective

Additional disclosures due to COVID

XYZ Private Limited Balance Sheet as at Mar 31, 20xx

Correct Disclosure

Refer Notification dated 4th september, 2015.

(b) Trade payables:-

(A) total outstanding dues of micro enterprises and small enterprises; and

(B) total outstanding dues of creditors other than micro enterprises and small enterprises.]

Particulars			as at the end of the previous reporting period
4) Current liabilities			
(a) Short-term borrowings			
(b) Trade payables			
(c) Other current liabilities			
(d) Short-term provisions			

Trade Payables

- Total of Trade payables – Rs 88.45 lacs
- The ageing analysis reveals the following
 - O/s for < one year - Rs 60.28 Lacs
 - O/s for > one year < 3 years - Rs 25.27 Lacs
 - O/s for > 5 years - Rs 2.90 Lacs

Current
Liability?

Non Current
Liability?

XYZ Private Limited

Balance Sheet as at Mar 31, 20xx

Correct Disclosure

[Refer Notification dated 11th October 2018.](#)

(1) (a) Property, Plant and Equipment and Intangible assets

[Substituted by Amendment to Schedule III to the Companies Act, 2013. Effective from 01st April 2021](#)

(i) Property, Plant and Equipment

Particulars	end of the previous		
II. ASSETS			
Non-current assets			
(1) (a) Fixed Assets			
(i) Tangible assets			
(ii) Intangible assets			
(iii) Capital work-in-progress			
(iv) Intangible assets under development			

XYZ Private Limited

Balance Sheet as at Mar 31, 20xx

Particulars	
(2) Current assets	
(a) Current investments	
(b) Inventories	
(c) Trade receivables	
(d) Cash and cash equivalents	Q. Cash and cash equivalents
(e) Short-term loans and advances	(i) Cash and cash equivalents shall be classified as:
(f) Other current assets	(a) Balances with banks;
	(b) Cheques, drafts on hand;
	(c) Cash on hand;
	(d) Others (specify nature).
	(ii) Earmarked balances with banks (for example, for unpaid dividend) shall be separately stated.
	(iii) Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments shall be disclosed separately.
	(iv) Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated.
	(v) Bank deposits with more than twelve months maturity shall be disclosed separately.

Cash & Cash equivalents

(Refer Para 6.3 & 6.4 of ICAI GN on the Schedule III to the Companies Act, 2013)

- According to AS-3 Cash Flow Statements, Cash is defined to include cash on hand and demand deposits with banks. **Cash Equivalents are defined as short term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.**
- Normally, deposits with original maturity of three months or less only should be classified as cash equivalents.
- Further, bank balances held as margin money or security against borrowings are neither in the nature of demand deposits, nor readily available for use by the company, and accordingly, do not meet the aforesaid definition of cash equivalents.
- Apparent **conflict between the requirements of the Schedule III and the Accounting Standards**

Cash & Cash equivalents

(Refer Para 6.3 & 6.4 of ICAI GN on the Schedule III to the Companies Act, 2013)

- ❑ As laid down in the General Instructions, Para 1 of Schedule III, requirements of the **Accounting Standards would prevail over the Schedule III** and the company should make necessary modifications in the Financial Statements, which may include addition, amendment, substitution or deletion in the head/sub-head or any other changes interse.
- ❑ The conflict should be resolved by changing the caption “**Cash and cash equivalents**” to “**Cash and bank balances,**” which may have two sub-headings, viz., “Cash and cash equivalents” and “Other bank balances.”
- ❑ The former should include only the items that constitute Cash and cash equivalents defined in accordance with AS 3 (and not the Schedule III)
- ❑ The remaining line-items may be included under the latter heading.

Other Bank Balances

- balances with banks to the extent held as margin money or
- security against borrowings etc
- bank deposits with more than three months maturity
- Banks deposits with more than twelve months maturity will also need to be separately disclosed

The **non-current portion** of each of the above balances will have to be classified under the head “**Other Non-current assets**” with separate disclosure thereof.

Advance for Capital Purchase

- Capital budget for Rs 100 lakhs approved in Jan 2021
- Project to be completed before Dec 2021
- Advance paid in feb 2021
 - Domestic Vendors – 15 lakhs
 - Overseas Vendors – 35 lakhs (USD 50,000)
- One overseas vendor shipped PPE worth USD 15,000 on Mar 20, 2021.
Balance due USD 2500.
- PPE reached the buyer on April 15, 2021

Current
assets?

Non Current
assets?

Goods in transit? /GIT/CGIT/FE
restatement/Liability accounting/
Contingent liability

FRRB Observations on Accounting Standards

1. From the notes to accounts given In the Annual Report of a company, **it has been noted that accounting policies were given** under various notes to accounts instead of stating all such policies under a single head of significant accounting policies.

Non compliance with para 25 of AS 1 – Disclosure of Accounting Policies. The said para requires that the disclosure of the significant accounting policies as such should form part of the financial statements **and the significant accounting policies should normally be disclosed in one place.**

2. Contingent liabilities has been disclosed under various notes instead of disclosing the same at one place

- Paragraph 20 of Accounting Standard (AS) 1, ‘Disclosure of Accounting Policies’, states:

“It would be helpful to the reader of financial statements if they are all disclosed as such in one place instead of being scattered over several statements, schedules and notes.”

Hence, it was viewed that the presentation of the information has not been made as required by the spirit of paragraph 20 of AS 1

FRRB Observations on Accounting Standards

1. Impairment losses, if any, are recognised in accordance with the accounting standard issued in this regard by the Institute of Chartered Accountants of India.
2. Provision for Current Tax been made as per the provisions of Income Tax Act, 1961 and adjustment for Deferred Tax is made in accordance with Accounting Standard-22

The accounting policies refer to the specific accounting principles and the methods of applying those principles adopted by the enterprise in the preparation and presentation of financial statements. (Para 11 of AS 1)

Companies have merely mentioned in their accounting policies that they are in accordance with the requirements of the accounting standards as issued by the Institute.

It was viewed by FRRB that the accounting policies should be explicitly stated.

Reference should have been made to the Accounting Standards notified under the Companies (Accounting Standards) Rules 2006, rather than those issued by the Institute of Chartered Accountants of India.

FRRB Observations on Accounting Standards

1. Income is recognised on accrual basis.
2. Sales comprises sale of goods net of excise duty and include export benefits.
3. Revenue is recognised and expenditure is accounted for on their accrual.

The policies above omit to state explicitly the point of time when significant risks and rewards in goods stand transferred to the buyer and revenue is recognised in the books of accounts.

The policy regarding timing of recognition of revenue arising from sale is an important accounting policy for any company and therefore, it should be disclosed as per the requirements of paragraph 24 of AS 1.

FRRB Observations on Accounting Standards – AS 2

1. Useful designs are valued at actual cost and Stock in progress is valued at direct cost
2. Bunkers remaining on Board are valued at weighted average cost.
3. Raw materials and stores and spares are valued at cost.
4. Raw Material & Components, Stores and Spares, Die Steel Blocks are valued at cost and Work in progress is valued at estimated cost.

In the above cases, the inventories have been stated to be valued only at cost. paragraph 5 of AS 2 requires that inventories should be valued at the lower of cost and the net realisable value.

Accordingly, the stated accounting policies are not in line with the requirements of AS 2.

Further, the cost formula used for valuation of inventories, is required to be disclosed as per paragraph 26(a) of AS 2.

FRRB Observations on Accounting Standards – AS 2

- The schedule of ‘Inventories’ given in the Annual Reports of some companies, inventories were described **“as taken, valued and certified by the management.”**

ICAI Guidance Note on Audit of Inventories, has clarified that the use of expression **‘as valued and certified by the management’** may lead the users of financial statements to believe **that the auditor merely relies on the management’s certificate without carrying out any other appropriate audit procedures** to satisfy himself about the existence and valuation of inventories.

Therefore, usage of phrase viz **“as valued and certified by the management”** indicates **that there is a disclaimer for inventories which should be avoided.**

ICAI GN further states that **auditors may advise their clients to omit** the expression **“as valued and certified by the management”**, when describing inventories in the financial statements.

FRRB Observations on Accounting Standards – AS 2

- Inventories are valued at **cost or net realisable value, whichever is lower.** Costs comprise all cost of purchase, cost of conversion and other costs incurred in bringing the inventories to their present location and condition. **‘First-in- first-out’ or ‘Average cost’ method is followed for determination of cost.**

As per Para 16 - The cost of inventories, other than those dealt with in paragraph 14, should be assigned by using the first-in, first-out (FIFO), or weighted average cost formula. The formula used should reflect the fairest possible approximation to the cost incurred in bringing the items of inventory to their present location and condition.

The company has used the ‘Average Cost’ method and not the ‘weighted average cost’ method for the determination of cost, which is not in line with the requirement of paragraph 16 of AS 2.

FRRB Observations on Accounting Standards – AS 2

- From the schedule of Current Assets given in the Annual Report of a company, it has been noted that **Stock in Trade also includes** the stock of **DEPB Receivables** as well as **Plant & Machinery retired** from active use.

As per para 3.1 Inventories are assets:

- held for sale in the ordinary course of business;
- in the process of production for such sale; or
- in the form of materials or supplies to be consumed in the production process or in the rendering of services.”

DEPB Receivables should be treated as a part of loans and advances and it should not be included in stock in trade.

Further, the Plant & Machinery retired from active use is a part of fixed assets; hence, it should also be not included in stock in trade. It was viewed that such assets should have been shown separately in the fixed assets schedule as “held for disposal”.

FRRB Observations on Accounting Standards – AS 9

- Sales revenue is recognised when property in the goods with all significant risk and rewards as well as the effective control goods usually associated with ownership, are transferred to the buyer, at a price and **includes excise duty and exchange fluctuation** in case of the export.

As per para 4.1. Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends...”

The **foreign exchange fluctuation is not an inflow of cash receivable** etc. **arising from the sale of goods but from settlement of non- monetary item.** Hence, accounting such fluctuation as part of Sales revenue **is not in accordance with the aforesaid paragraph of AS 9.**

FRRB Observations on Accounting Standards – AS 9

- Sales include duty drawback, license premium on exports, and insurance claims on stocks and are recorded net of trade discounts and other rebates.

As per para 4.1. Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends. Revenue is measured by the charges made to customers or clients for goods supplied and services rendered to them and by charges and rewards arising from the use of resources by them.....

Duty drawback, license premium on exports and insurance claims on stocks/ have not been disclosed separately, instead the reported sales have been increased by them.

The receipts from said items is not a consideration arising from sale of goods. Hence, they should not be merged with the sales and should be disclosed as separate line items. **This aspect has also been explained in the Expert Advisory Opinion (Query No. 1.15, Volume VI, page 43).**

FRRB Observations on Accounting Standards – AS9

- Inter divisional transfers of goods, as marketable products produced by separate divisions of the company for captive consumption are made as if sales were to third parties at current market prices and are included in turnover.

It may be noted that the ICAI has issued an Announcement titled as ‘Treatment of Inter-divisional Transfers’, which provides that:

“Since in case of inter- divisional transfers, **risks and rewards remain within the enterprise** and also there is **no consideration from the point of view of the enterprise as a whole**, the recognition criteria for revenue recognition are also not fulfilled in respect of inter-divisional transfers.”

Thus, the recognition of inter- divisional transfers as sales indicates an inappropriate recognition of revenue, which is not in line with AS 9.

Accounting Standards – AS10

- *Property, plant and equipment are stated at **cost of acquisition** or construction less accumulated depreciation less accumulated impairment, if any.*

Elements of Cost

Para 17. The cost of an item of property, plant and equipment comprises:

(a) its purchase price, including import duties and **non –refundable purchase taxes**, after deducting trade discounts and rebates.

(b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

FRRB Observations on Accounting Standards – AS 11

- Any income and expense on account of exchange rate difference either in settlement or on translation is recognised in the Profit and Loss Account except in cases where they related to acquisition of fixed assets, in which case, they are adjusted to the carrying cost of such assets.
- ***13. Exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or as expenses in the period in which they arise, with the exception of exchange differences dealt with in accordance with paragraph 15.***
- In view of the above, capitalisation of foreign exchange differences is not allowed as per AS 11,
- AS 11 as issued by Ministry of Corporate Affairs and published in the Notification in the Official Gazette dated 7th December, 2006, carries the following footnote:
- “It may be noted that the accounting treatment of exchange differences contained in this Standard is required to be followed irrespective of the Companies Act, 1956.”

FRRB Observations on Accounting Standards – AS 15

- Provision for gratuity has been made on the basis of actuarial valuation in the accounts in respect of employees who have completed qualifying period of service.

Question No. 14 of ASB Guidance on Implementing AS 15, Employee Benefits (revised 2005), issued by the Accounting Standards Board, states as follows:

“In this case, the employee’s right to receive the benefit is conditional on future employment for a period of five years. 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. The obligation arises when the employee renders the service though the benefit is not vested

Keeping in view of the above, it was felt that the provision should be created in respect of gratuity payable during the first five years of service for all employees rather than creating provision for those employees who have completed qualifying period of service.

CARO - Applicability

- The Order provides **that it shall not apply** to:
- a banking company, an insurance company, a section 8 company, a One person Company and a **Small Company** as defined under clause (85) of the section 2 of the Act;
- (v) a private limited company, not being a subsidiary or holding company of a public company, **having a paid up capital and reserves and surplus not more than rupees one crore** as on the balance sheet date and which does not **have total borrowings exceeding rupees one crore** from any bank or financial institution at any point of time during the financial year and **which does not have a total revenue as disclosed in Schedule III to the Act, (including revenue from discontinuing operations) exceeding rupees ten crores** during the financial year as per the financial statements.

CARO- Paragraph 3(i)(b)

- *Fixed assets have been physically verified by the management and no material discrepancies were noticed on such verification*
- The Order requires the auditor to report whether the management has verified the fixed assets at **reasonable intervals**.
- While an annual verification may be reasonable, it may be impracticable to carry out the same in some cases.
- Even in such cases, the verification programme should be such that all assets are verified at least once in every three years.
- Where verification of all assets is not made during the year, it will be necessary for the auditor to report that fact, **but if he is satisfied regarding the frequency of verification he should also make a suitable comment to that effect.**

CARO- Paragraph 3(i)(c)

- ***Whether the title deeds of immovable properties are held in the name of the company. If not, provide the details thereof; [Paragraph 3(i)(c)]***
- The reporting under this clause, where the title deeds of the immovable property are not held in the name of the Company, may be made incorporating following details, in the form of a table or otherwise:

a. In case of land:-

total number of cases,
whether leasehold / freehold,
gross block and net block, (as at Balance Sheet date), and remarks, if any.

b. In case of Buildings:-

Total number of cases,
gross block & net block, (as at Balance Sheet date) and remarks, if any.

➤ **Inventory** [Paragraph 3(ii)]

*Whether physical verification of inventory has been conducted at reasonable intervals by the management and **whether any material discrepancies were noticed and if so, whether they have been properly dealt with in the books of account;***

- The discrepancies noticed on verification between the physical stocks and the book records were not material.
- The discrepancies noted on physical verification of inventories as compared to book records were not material and have been properly dealt with in the books of account.

➤ **Statutory Dues** [Paragraph 3(vii)(a)]

*Whether the company is **regular** in depositing **undisputed statutory dues** including Provident Fund, employees' State Insurance, Income-tax, Sales-tax, Service Tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and*

***if not**, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated*

Disputed vs Undisputed - Need positive evidence or action on the part of the company to show that it has not accepted the demand for payment of tax or duty

Statutory Dues

- “Dues” include taxes, interest & penalty
 - a) Regular Payment
 - b) Generally Regular but slight delay in a few months
 - c) Not regular but delay not serious
 - d) Not regular and serious delay

As per ICAI GN on CARO, the above four situations warrants different disclosure.

The concept of Materiality to be kept in mind

Statutory Dues

1. Regular Payments through the year

- “undisputed statutory dues including..... and GST have **been regularly deposited** by the company with the appropriate authorities in all cases during the year”.

2. Generally Regular but **slight delay** in a few months

- “undisputed statutory dues including..... and GST have been regularly deposited by the company with the appropriate authorities **though there has been a slight delay** in a few cases”.

Statutory Dues

3. Not Regular but **delay not serious**

- “undisputed statutory dues including..... and GST have **not generally been regularly deposited** with the appropriate authorities though the **delay in deposit have not been serious.**

4. Not Regular and **serious delay**

- “undisputed statutory dues including..... and **GST have not been regularly deposited** with the appropriate authorities though there **have been serious delays** in a large number of cases”.

We often come across financials with notes regarding non confirmation of receivables / payables, reconciliation pending in respect of certain items, etc.

Internal audit report has following observations/comments :

- a) BRS not done on monthly basis.
- b) Travel advances not settled within prescribed time limit.
- c) Short accounting for GST liability
- d) Frequent claim of ineligible ITC
- e) Claim of ITC based on 2A without actual receipt of goods or services.
- f) Comments on efficacy of controls in accounting for Input & output GST.

Consider the impact of IA report while drafting Audit report & Internal Financial Control Report

TAX AUDIT REPORT

- **Commonly Found Errors:**
- *a) Many of the Tax Audit reports do not have the paragraphs relating to Assessee's responsibility and Tax Auditor's responsibility as required by the Guidance Note in respect of SA 700.*
- *b) Some of the tax audit reports contained a reference about the attached physically signed tax audit reports which mention these Paragraphs thereby complying with the requirement of SA 700.*
- **However, as per the Guidance Note on Tax Audit the same are specifically required to be mentioned / reported under clause (3) of Form No.3CA or Clause (5) of Form No.3CB, as the case may be.**

(please refer ICAI APPROACH TO TAX AUDIT UNDER SECTION 44AB OF THE INCOME TAX ACT, 1961)

TAX AUDIT REPORT

- **Commonly Found Errors:**
- *In certain tax audit reports that were examined, it has been observed that the qualification paragraph i.e. clause (3) of Form No.3CA or Clause (5) of Form No.3CB, as the case may be, contained a reference to Notes to Form No. 3CD. These notes did not mainly contain the qualifications but also contain general additional information.*
- *As per the Guidance Note only qualifications/ observations should be reported in the space provided in the form No. 3CA/3CB itself while the additional information which are not in the nature of qualification could be attached as notes.*

(please refer ICAI APPROACH TO TAX AUDIT UNDER SECTION 44AB OF THE INCOME TAX ACT, 1961)

GST under RCM

Sl.No	Ledger Account / Line item	Services rendered by	Recipient of Service
1	Transport charges/Freight	Goods Transport Agency	Factory\Society\Co-op society\person regd under GST\Body corporate\Partnership firm\AOP\casual taxable person located in the taxable territory.
2	Legal charges	Legal services rendered by an Advocate/ Sr. Advocate/ firm of Advocates	Any business entity located in the taxable territory
3	Arbitration fees	Services rendered by an arbitral tribunal	Any business entity located in the taxable territory
4	Sponsorship expenses	Any person	Body corporate & partnership firms located in the taxable territory
5	Project expenses – Transfer of development rights	Any person	Promoter of the project

GST Under RCM

Sl.No	Ledger Account / Line item	Services rendered by	Recipient of Service
6	Lease rentals Payment made for long term lease of land(>30 years) for construction of a project	Any person	Promoter of the project
7	Payments to Directors	A Director of the company making the payment	Corporate
8	Security services	Any person other than a body corporate	A registered person located in the taxable territory
9	Conveyance expenses Renting of motor vehicle	Any person	A body corporate located in the taxable territory

Going Concern Key Considerations for Auditors amid COVID-19

- Has management performed a preliminary assessment of the entity's ability to continue as a going concern? Whether auditor has discussed with management the impact of the COVID-19 outbreak, if any, on their assessment?
- Were there interruptions in the supply and production cycle of the entity due to the COVID-19 outbreak? If so, does management have a feasible recovery plan? Do these events or conditions cast significant doubt about the entity's ability to continue as a going concern?
- Are these disruptions expected to continue for a foreseeable future and the action plan of the management to mitigate these risks?

Going Concern Key Considerations for Auditors amid COVID-19

- Did the auditor note any contradiction in audit evidence provided by the entity (e.g., different assumptions or inputs used for different purposes)?
- Are there any financial difficulties, resulting in additional credit risks, higher than usual bad debts and potential impairments and write-offs because of the COVID-19 outbreak?
- Has management considered these situations in their assessment of the entity's ability to continue as a going concern?
- Are there any potential issues related to debt, including debt covenants, which are applicable to the entity (for example, is the entity in compliance with debt covenants or do debt agreements contain material adverse change clauses or call provisions)? Has management considered these situations in their assessment of the entity's ability to continue as a going concern?
- Whether the auditor considered the risk of inadequate disclosures in the financial statements related to the COVID-19 outbreak and management's recovery plans?

Going Concern Key Considerations for Auditors amid COVID-19

- **Emphasis of Matter**

- As more specifically explained in **Note ...** to the financial statements, the Company has made a detailed assessment of its liquidity position for the next year and the recoverability and carrying value of its assets comprising property, plant and equipment, investments, inventory and trade receivables. Based on current indicators of future economic conditions, the Company expects to recover the carrying amount of these assets. The Company continues to evaluate them as highly probable considering the orders in hand. The situation is changing rapidly giving rise to inherent uncertainty around the extent and timing of the potential future impact of the COVID-19 pandemic which may be different from that estimated as at the date of approval of the financial results. The Company will continue to closely monitor any material changes arising of future economic conditions and impact on its business.

Our opinion is not modified in respect of the above matters.

To Conclude

- Continuous enhancement of knowledge is a must
- Strong foundation in auditing
- Expert knowledge of AS & AAS
- Thorough if not expert knowledge of all relevant laws
- Never review FS without having the latest Schedule III and the ICAI GN on the same

Thank You

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