Regulatory Compliances

Schedule II & III of Companies Act, 2013

Financial Reporting Review Board

Coverage

Schedule III: Financial Statement Disclosure Requirements

Schedule II: Depreciation

Schedule III - Financial Statement Disclosure Requirements (Coverage)

<u>Key Concepts</u>

Common Non-compliances observed by the Financial Reporting Review Board (FRRB)

Key Concepts - Background

- **Schedule III** read with section 129 of the Companies Act, 2013 **prescribes the format of the financial statements (i.e. Balance sheet and Statement of Profit and Loss)** and general instructions for preparation of the same. **Format of Cash flow statement is governed by AS-3**.
- Schedule III of Companies Act, 2013 replaces Revised Schedule VI (with additional requirements for preparation of CFS).
- Schedule III (Division II) prescribe format for Ind-AS compliant financial statements.

- If compliance with the requirements of the Act including Accounting Standards requires a change in the treatment or disclosure in the financial statements, then the changes as per the requirements of the Act/ Accounting Standards shall be made and the requirements of Schedule III shall stand modified accordingly.
- Information relating to each item on the face of the Balance Sheet and the Statement of Profit & Loss to be disclosed in the notes with a cross reference.

Key Concepts – Schedule III and AS

- Disclosure Requirements specified in Schedule III are **in addition to** and not in substitution of the Disclosure Requirements specified in Accounting Standards prescribed under the Companies Act
- Additional Disclosures specified in the Accounting Standards to be made in the **Notes to Accounts** or by way of **Additional Statement**, unless required to be disclosed on the face of the Financial Statements.
- All other disclosures as required by the Companies Act to be made in the **Notes to Accounts** in addition to requirements set out in Schedule III.

- Requirement of Schedule III applies to Consolidated financial statements too. Earlier, consolidated financial statements were required only for listed companies.
- Additional information by way of parent / subsidiaries share in the net assets and profit or loss etc. are required to be given.
- Consolidated financial statements to be audited, approved and adopted in similar way as standalone financial statements.

Schedule III – Financial Statement Disclosure Requirements

Common Non-compliances observed by Financial Reporting Review Board (FRRB)

Non compliances on Disclosures regarding Share Capital

Principle:

Paragraph 6A (d) & (e) of General Instructions for Preparation of Balance Sheet of Part I, Schedule III to Companies Act, 2013.

Observation:

From the 'Share Capital Disclosures' given in the Annual Report of some companies, it was observed:

- Company having only one class of shares (Equity) **had not disclosed rights, preference and restrictions with respect to such shares**, which should be disclosed even if it has only class of shares.
- Reconciliation of each class of shares outstanding at the beginning and at the end of the period, was not disclosed. It was viewed that a disclosure for each class of shares with opening number of shares outstanding, shares issued, bought back, other movements and closing number of shares outstanding should be given (Refer Guidance Note Para 8.1.1.9)

Hence, **non-disclosure of rights, preference and restrictions attaching to each class of shares as well as reconciliation of shares outstanding** are not in line with the requirement of Paragraph 6A of General Instructions for Preparation of Balance Sheet of Part I, Schedule III to Companies Act, 2013.

Principle:

Paragraph 6A(b), (f), (k) of General Instructions for Preparation of Balance Sheet of Part I, Schedule III to Companies Act, 2013.

Observation:

From the 'Share Capital Disclosures' given in the Annual Report of some companies, it was observed that:

- Under the Disclosure regarding shareholders holding more than 5% shares, it is stated that "a company" is holding more than 51% shares. However, **a specific disclosure regarding shares held by the holding company was not made**, which is not in line with **Para 6 A (f)** of Schedule III to Companies Act, 2013.
- **Unpaid calls shown as receivable without adequate disclosure.** It was viewed that gross amount of Shares Capital should be disclosed first and then calls unpaid should be reflected as a deduction. **[Refer Para 6A(b) & Para 6A(k)]**
- **Share Application Money pending for allotment reflected as part of Share Capital instead of disclosing it as a separate line item** after Shareholders' Funds and before Non- Current Liabilities. **(Refer Part I- Form of Balance Sheet)**
- Reconciliation of each class of shares outstanding at the beginning and at the end of the period, was not disclosed. It was viewed that a disclosure for each class of shares with opening number of shares outstanding, shares issued, bought back, other movements and closing number of shares outstanding should be given (Refer Guidance Note Para 8.1.1.9)

Hence, **non-disclosure of rights, preference and restrictions attaching to each class of shares as well as reconciliation of shares outstanding** are not in line with the requirement of Paragraph 6A of General Instructions for Preparation of Balance Sheet of Part I, Schedule III to Companies Act, 2013.

Non compliances on
Disclosures regarding Reserve & Surplus

Non compliances on Disclosures regarding Reserve & Surplus

Principle:

Paragraph 6 B (i) of General Instructions for Preparation of Balance Sheet of Part I, Schedule III to Companies Act, 2013.

Observation:

From the 'Reserve and Surplus Disclosures' given in the Annual Report of some companies, it was observed that:

- For each of the specified head of reserves & Surplus, **only the final amount at the end of the period were reflected, without disclosing movement during the year** i.e. addition and deduction since last balance sheet. [Refer Para 6 B (i)]
- **Appropriations from Profit for the year were reflected on the face of the Statement of Profit and Loss.** This was the practice as per Old Schedule VI. However, as per Para 6B(i)(h), the appropriations and allocations such as dividend, transfer to / from reserves **has to be made through Reserves and Surplus after transfer of Surplus from Statement of Profit and Loss**.
- **Debit Balance of Statement of Profit and loss was reflected on Assets side of the Balance Sheet instead of showing as a negative figure under the head surplus**. Even, after adjusting the balances of other Reserves the final balance is negative, the same will continue to be reflected as a negative figure in Reserves and Surplus.
- Reconciliation of each class of shares outstanding at the beginning and at the end of the period, was not disclosed. It was viewed that a disclosure for each class of shares with opening number of shares outstanding, shares issued, bought back, other movements and closing number of shares outstanding should be given (Refer Guidance Note Para 8.1.1.9)

Hence, **non-disclosure of rights, preference and restrictions attaching to each class of shares as well as reconciliation of shares outstanding** are not in line with the requirement of Paragraph 6A of General Instructions for Preparation of Balance Sheet of Part I, Schedule III to Companies Act, 2013.

Non compliances on Disclosures regarding Long Term and Short Term Borrowings

Non compliances on Disclosures regarding Long Term and Short Term Borrowings

Principle:

Paragraph 6 C, 6 G of General Instructions for Preparation of Balance Sheet of Part I, Schedule III to Companies Act, 2013.

Observation:

From the 'Note on Long Term Borrowings and Short Term Borrowings' given in the Annual Report of some companies, it was observed that:

- Secured Borrowings includes loan availed by creating charge on the property of a director and his personal security. However, there **is no disclosure of such security offered for borrowing.** Also, these borrowings has not been classified as secured borrowings. (Refer Para 8.3.1.13 of GN)
- **Current Maturities of Long Term Borrowings were reflected as Short Term Borrowings** instead of disclosing it under the head "**Other Current Liabilities**". (Refer Para 6G(a) read with 8.3.1.10 of GN).
- Bonds/ Debentures were disclosed with the type of bonds/ debentures and rate of interest only. As per Para 6C(iv), **disclosure for bonds/ debentures should also include particulars of redemption/ conversion** and shall be stated in descending order of maturity or conversion date.

Non compliances on Disclosures regarding Long Term and Short Term Borrowings

Principle:

Paragraph 6 C, 6 F (i) of General Instructions for Preparation of Balance Sheet of Part I, Schedule III to Companies Act, 2013.

Observation:

From the ‘Note on Long Term Borrowings and Short Term Borrowings’ given in the Annual Report of some companies, it was observed that:

- Classification of Loan as a non current liability in the previous year, which on becoming a current liability during the current financial year, the company re-classified the loan as current for previous year also. Classification of current/ non-current is as of a particular date i.e Balance Sheet date. **If there is a change in classification during subsequent year it is so, for that year. It would not change the position as of previous year and hence previous year classification should remain unchanged.**
- A Convertible Debt instrument maturing after 2 years, where the conversion option for issuance of equity is exercisable by the holder at any time classified as “Short Term Borrowing ”. **The terms of settlement of a liability do not affect its classification.** In the instant case the maturity for cash settlement was after 2 years and accordingly the same should have been classified as “Non-Current”. (Refer GN Para 7.5.1).

A Convertible Debt instrument maturing after 2 years, where the conversion option for issuance of equity is exercisable by the holder at any time classified as “Short Term Borrowing ”. The terms of settlement of a liability do not affect its classification. In the instant case the maturity for cash settlement was after 2 years and accordingly the same should have been classified as “Non-Current”. (Refer GN Para 7.5.1).

Non compliances on
Disclosures regarding Trade Payable

Non compliances on Disclosures regarding Trade Payable

Principle:

Paragraph 6 F (i) of General Instructions for Preparation of Balance Sheet of Part I, Schedule III to Companies Act, 2013.

Observation:

From the ‘Note on Trade payable’ given in the Annual Report of some companies, 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.**

It was viewed that any 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**”.(Refer Para 8.4.1 of GN).

Non compliances on Disclosures regarding Provisions

Principle:

Paragraph 6 E & H of General Instructions for Preparation of Balance Sheet of Part I, Schedule III to Companies Act, 2013

Observation:

From the 'Note on Provisions' given in the Annual Report of some companies, it was observed that valuation of Gratuity/ Leave Encashment done by Actuary, provided current and non-current portion for both, but Gratuity was classified as Long Term Provision and Leave Encashment was classified as Short Term Provision.

It was viewed that **if there is a classification provided by Actuary on the basis of retirement and attrition rate, then the current portion of both should be treated as Short Term Provision and non-current portion of both should be treated as Long Term Provision**.

Non compliances on
Disclosures regarding Fixed Assets

Non compliances on Disclosures regarding Fixed Assets

Principle:

Paragraph 6 I & J of General Instructions for Preparation of Balance Sheet of Part I, Schedule III to Companies Act, 2013

Observation:

From the ‘Note on Fixed Assets’ given in the Annual Report of some companies, it was observed that:

- **A company having Tangible and Intangible assets did not categorize the same accordingly.** As per Para 6 I and J, there is a requirement to classify assets into Tangible and Intangible Assets. Further, as in Tangible Assets where the work in under progress is disclosed separately as **Capital Work in Progress**, for Intangible Assets also which are under development, there is a requirement to disclose it separately as **Intangible Assets under Development**.
- Advance given for Capital Asset where the work is under progress was included in Capital Work in Progress. It was viewed that **any advance for purchase /construction of fixed assets has to be classified as Long Term Loans and Advances**. (Refer Para 6 L(i)(a) Capital Advances).
- Tangible Assets included owned assets as well as leased assets, however, **no such break up provided in the Note on Tangible/ Fixed Assets.**

Non compliances on Disclosures regarding Investments.

Non compliances on Disclosures regarding Investments

Principle:

Paragraph 6 K of General Instructions for Preparation of Balance Sheet of Part I, Schedule III to Companies Act, 2013

Observation:

From the ‘Note on Investments’ given in the Annual Report of some companies, it was observed that:

- **Investment in Associate and Joint Venture was not disclosed**, though such disclosure was made in Related Party Transactions. There is a requirement in Para 6 K(i) to separately categorize investments in subsidiaries, associates, joint ventures with extent of investment in such entities.
- **Investment in Partnership Firms included investment in LLPs.** It was viewed that LLP is a body corporate and not a partnership firm. Hence disclosures of investment in Partnership Firms would not include investment in LLPs. **Such investments should be disclosed separately under “Other Investments”**. Other disclosures required for Partnership Firms also need not be made for LLPs.

Non compliances on
Disclosures regarding Inventories

Principle:

Paragraph 6 O of General Instructions for Preparation of Balance Sheet of Part I, Schedule III to Companies Act, 2013

Observation:

From the 'Note on Inventories' given in the Annual Report of some companies, it was observed that:

- Trading Stock of the Company which was into manufacturing and trading activities, was included in Finished Goods Stock. As per Para 6 O(i)(d) there is a **requirement to disclose separately Stock-in-Trade (in respect of goods acquired for trading).**
- Goods in Transit including towards Raw Materials, Stock-in-trade and Stores and spares, was disclosed together as such. As per Para 6O(i)(ii) there is a requirement that **Good-in-transit for each category of inventory should be disclosed under the relevant sub-head of inventories**.

Non compliances on
Disclosures regarding Trade Receivables

Principle:

Paragraph 6 P of General Instructions for Preparation of Balance Sheet of Part I, Schedule III to Companies Act, 2013

Observation:

From the ‘Note on Trade Receivables’ given in the Annual Report of some companies, it was observed that:

- **Trade Receivables outstanding for more than six months were considered from the date of invoice.** As per Para 6P(i) Trade Receivables outstanding for a period exceeding six months is to be considered from the date they are **due for payment.**
- **Trade Receivables included receivables due from sale of Fixed Assets and Investments.** It was viewed that a Trade Receivable is only in respect of the amount due on account of goods sold or services rendered in the ordinary course of business. Amount due on account of other contractual obligations cannot form part of Trade Receivables but are to be classified as **“ Others”** (Refer Para 8.7.4 of GN).

Non compliances on Disclosures regarding Cash & Cash Equivalent

Non compliances on Disclosures regarding Cash & Cash Equivalent

Principle:

Paragraph 6 Q of General Instructions for Preparation of Balance Sheet of Part I, Schedule III to Companies Act, 2013

Observation:

From the 'Note on Cash & Cash Equivalent' given in the Annual Report of some companies, it was observed that:

- **Fixed Deposits having maturity beyond 12 months were disclosed under this head.** It was viewed that Fixed Deposits with more than 12 months maturity have to be disclosed as "**Other Bank Balances" and the non-current portion of such deposits should be classified under the head "Other Non-Current Assets**". (Refer Para 8.8.4 of GN).
- Balance in Unpaid Dividend Account was included in Balances with Banks under the Cash & Cash Equivalents. As per Para 6Q(ii) **earmarked balances with banks like unpaid dividend shall be separately stated and this should not form part of the Cash & Cash Equivalents** of the Company.

Non compliances on
Disclosures regarding Loans and Advances

Non compliances on Disclosures regarding Loans and Advances

Principle:

Paragraph 6 L & R of General Instructions for Preparation of Balance Sheet of Part I, Schedule III to Companies Act, 2013

Observation:

From the 'Note on Loans and Advances' given in the Annual Report of some companies, it was observed that:

- **Provision for Bad and Doubtful Advances were disclosed in aggregate for all types of Loans and Advances.** As per Para 6L(iii)(b) and 6R(iii) allowance for bad and doubtful loans and advances **shall be disclosed under the relevant heads separately.**
- **Loans and Advances to Related Parties were not disclosed separately under the head Loans and Advances**, though such disclosure was made in Related Party Transactions.. As per Para 6L(i)(c) and 6R(i)(a) **Loans and Advances to Related parties are to be disclosed separately with details thereof.** The term "details" should be interpreted to understand the disclosure requirements as per AS-18 Related Party Disclosure.

- Key concepts (Depreciation, Useful life, Residual value, Componentisation etc.)
- Common non compliances observed by the Financial Reporting Review Board (FRRB)

Key Concepts

- **Depreciation** is the systematic allocation of the Depreciable amount of an asset over its useful life.
- **The depreciable amount** of an assets is the cost of an asset or other amount substituted for cost, less its residual value.
- **Useful life** is the period over which an asset is expected to be available for use by an entity , or the number of production or similar units expected to be obtained from the asset by the entity.

- Depreciation begins when the asset 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
- Depreciation ceases when the asset is retired from active use and is **held for disposal** / the date that the asset is derecognised.
- Depreciation does not cease when the asset becomes idle unless the asset is fully depreciated.

Key Concepts

- The depreciation method should reflect the pattern in which the future economic benefits of the asset are expected to be consumed by the enterprise.
- The depreciation method should be reviewed at least at each financial year-end.
- If there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the depreciation method should be changed to reflect the changed pattern. Such a change should be accounted for as a change in an accounting estimate in accordance with AS 5.

Some of the key changes in the Schedule II to the Companies Act, 2103 are as follows:

- Schedule II prescribes indicative useful lives of various assets instead of Straight Line Method (SLM)/ Written Down Value (WDV) rates for calculating depreciation.
- Useful life is the period over which an asset is expected to be available for use by an entity, or the number of production or similar units expected to be obtained from the asset by the entity.
- Companies are allowed to follow different useful lives/ residual value if an appropriate justification is given, supported by technical advice.
- No separate rate for double/ triple shift; depreciation to be increased based on the double shift/triple shift use of the assets
- No reference to depreciation on low value assets.
- Component accounting and useful life of a significant part of an asset to be determined separately.

Component accounting:

- Where cost of a part of the asset is significant to total cost of the asset and useful life of that part is different from the useful life of the remaining asset, useful life of that significant part shall be determined separately. It is called as component accounting.
- The determination as to whether a part of an asset is significant requires a careful assessment of the facts and circumstances.
- Component accounting is required to be done for the entire block of assets as at 1 April 2014 if a company opts to follow it voluntarily and as at 1 April, 2015 mandatorily. It cannot be restricted to only new assets acquired after 1 April 2014 or 1 April, 2015 as the case may be.
- Earlier, companies need to expense replacement costs in the year of incurrence. However, under component accounting, companies will capitalize these costs as a separate component of the asset.

Charging of Depreciation in Case of Revaluation of Assets

- Schedule II to Companies Act, 2013 requires depreciation to be provided on ***historical cost or the amount substituted for the historical cost.*** Hence, in case of a revalued asset the depreciable amount should be the carrying value of the asset after revaluation.
- In such cases, the revaluation surplus may be transferred to the revenue reserves when the asset is **derecognised/ retired/ disposed off**.
- However, some of the surplus may be transferred as the **asset is used** by an enterprise. In such a case, the amount of the surplus transferred would be the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on its original cost. **Transfers from revaluation surplus to the revenue reserves are not made through the statement of profit and loss.**

Non Compliances regarding Schedule II to Companies Act, 2013

Case:

From the accounting policy on depreciation given in the annual report of a company, it was noted that management re-estimated the useful lives of all fixes assets in 2013. While comparing the lives estimated by management vis-à-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 to Companies Act.

Observation:

It was viewed that as per paragraph 3 of 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**. However, the company has neither given such disclosure nor the justification duly supported by technical advice for such difference. Even the useful lives of all the assets have been provided without any specific disclosure for the useful life which is different from the useful life prescribed under Schedule II which is not in line with the requirement of Schedule II to Companies Act, 2013

Case:

In the accounting policy of depreciation it is stated that the useful life of fixed assets is as per Schedule II to the Companies Act, 2013. It was noted that useful life of **X asset** as per Schedule II is **10 years**. However, in the Note on fixed asset, they have charged depreciation by considering useful life as **8 years**.

Observation:

It was viewed that **there is contradiction between the accounting policy adopted for the useful life of X Asset and the useful life disclosed in the Note of Fixed Assets**.

Case:

From the Accounting Policy given in Annual report of a Company it was noted that **depreciation on additions is calculated from the following month of addition.**

Observation:

As per the Schedule II to the Companies Act, 2013, **depreciation needs to be computed from the date of addition.**

Case:

From the Note on Fixed Assets of a Company, it was noted that the assets were transferred on April 29, 2xxx but the depreciation charged on such assets is reported as Rs. Nil.

Observation:

The case indicates that **depreciation up to the date of transfer has not been provided for, which is not in line with the requirement of Schedule II**.

Case:

Some of the assets of the company were depreciated based on estimated useful lives different from the useful life specified in the Schedule II.

Observation:

The case indicates that for the purpose of charging depreciation on assets company has used the **useful life of asset which is different than that specified under the Schedule II but no disclosure for the same has been made** which is not in line with the requirements of Schedule II to Companies Act, 2013.

Thank You