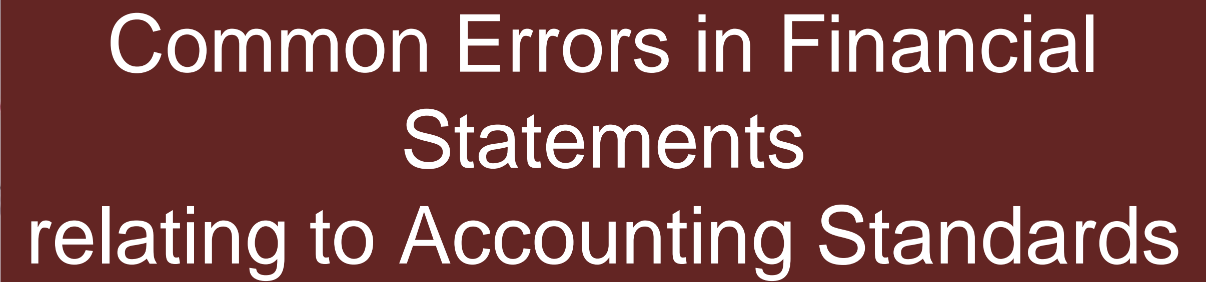
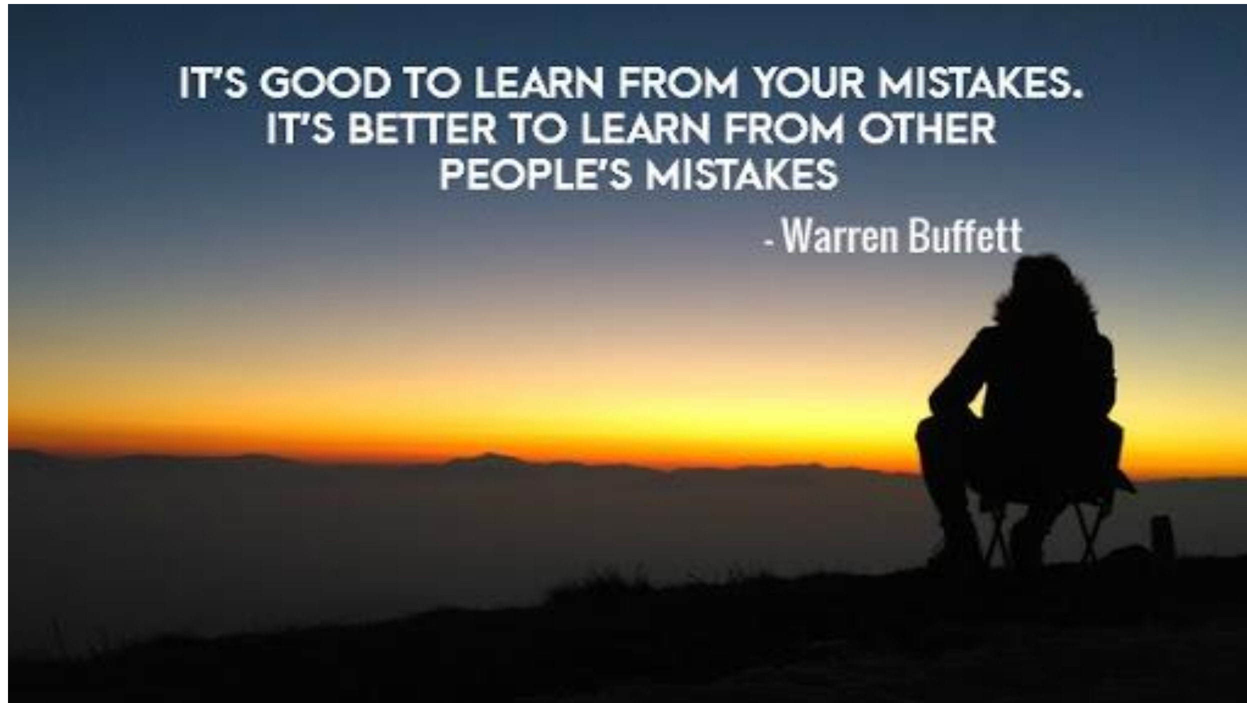
PUNE BRANCH OF WIRC OF ICAI

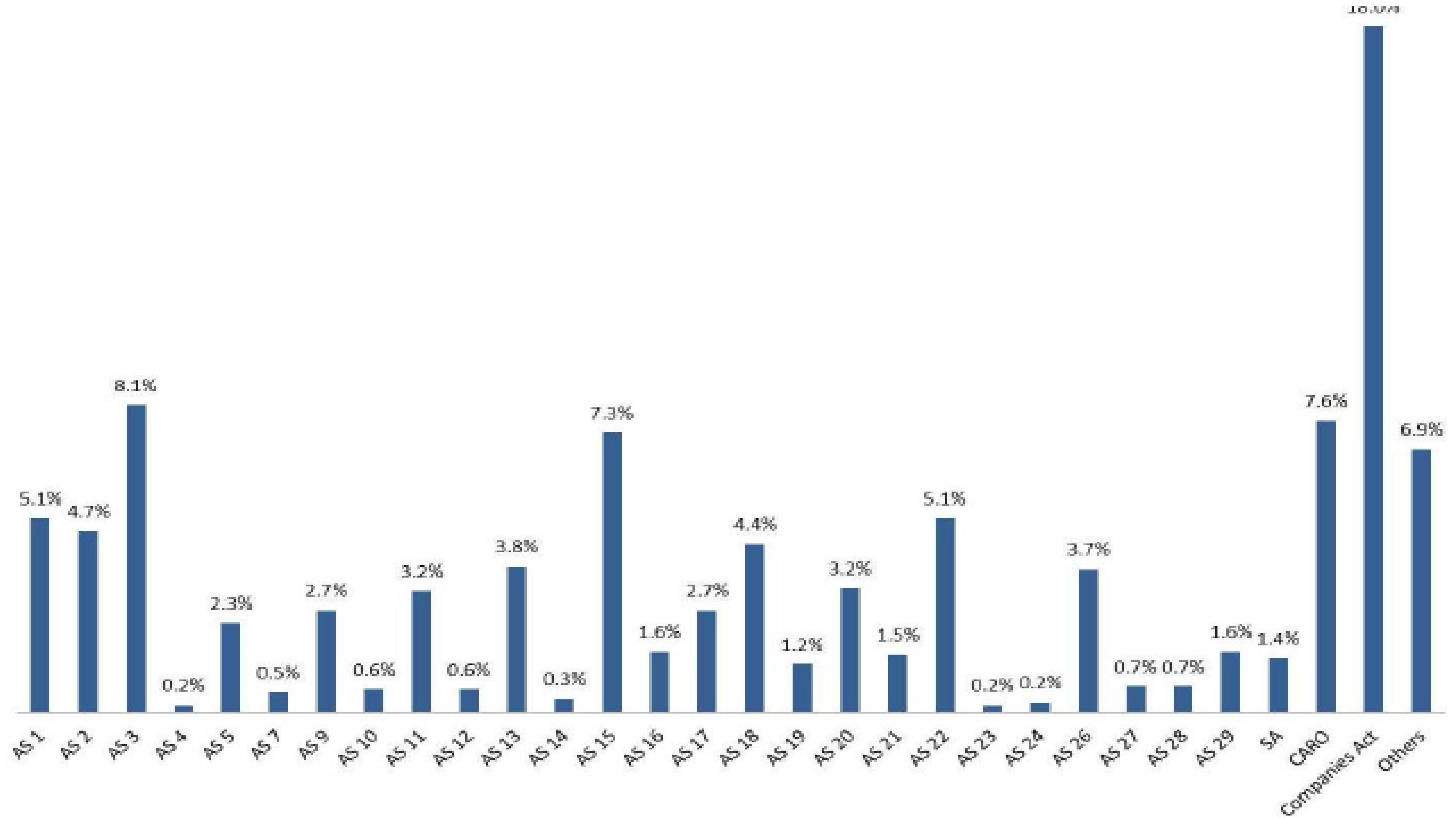


CA. Chintan N. Patel
Regional Council Member, WIRC of ICAI

13th June, 2021


IT'S GOOD TO LEARN FROM YOUR MISTAKES.
IT'S BETTER TO LEARN FROM OTHER
PEOPLE'S MISTAKES
- Warren Buffett

Deficiencies observed



Non - Compliance of Accounting Standards

AS 1 to 10

Case:

Certain companies omit to disclose significant accounting policies with regard to the following:

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

Principle:

Paragraphs 24 of AS 1

Observation:

It was observed that company in general, may have borrowed funds, inventories, investments, employees, taxes on income and assets which may be subject to impairment. Further, there is always a need to carry certain provisions for meeting the contingent liabilities. As per Paragraph 24 of AS 1, **all significant accounting policies** adopted in the preparation and presentation of financial statements ***should be disclosed***. Accordingly, subject to circumstances, a company is expected to disclose the accounting policies as adopted by it with regard to each of them.

Case:

Incorrect disclosure of valuation of Inventories:

The accounting policies regarding valuation of inventories as disclosed in the Annual Report of several companies are listed below:

- Stocks of Cards are valued at Cost and on FIFO basis and include all applicable overheads in bringing the inventories to their present location and condition. Work in progress is valued at Cost.
- Work -in -Progress is valued at direct raw material cost and appropriate cost of completed process.
- Raw materials are valued at average cost. Raw materials at bonded warehouse stores, spares, consumables, packing material, coal & fuel are valued at cost.
- Work in Process is valued at raw material cost.
- Cost of finished goods and work in progress are determined on estimated cost basis.
- Cost is determined by using the first in first out formula. Cost comprises all.

Principle:

Paragraphs 3.2, 5 and 6 of AS 2

Observation:

Inventories to be measured at lower for cost and net realisable value. Cost of inventories should comprise cost purchase, cost of conversion and other costs.

Case:

Incorrect disclosure of cost formula of Inventories:

From the Annual Reports of some companies following accounting policies have been noted:

- Inventories are stated at lower of cost and net realisable value. Cost is determined on weighted average/ first-in first-out (FIFO) basis, as considered appropriate by the Company.

- Cost of inventories is computed on weighted average / FIFO basis.

Principle:

Paragraph 16 and 26 of AS 2

Observation:

26. The financial statements should disclose (a) the accounting policies adopted in measuring inventories, including the cost formula used

It was viewed that although cost formula has been given in these cases, however, it would be more appropriate to ***disclose which cost formula has been used for which class of inventories***.

Case:

From the Cash Flow Statement given in the Annual Report of a Bank, it has been noted that net '**(Increase)/Decrease in Investments' has been disclosed under the head 'Cash Flow from Operating Activities.**'

Further, it has been noted from the note on Investments that such investments also include **'Held to maturity' investments**.

Principle:

Paragraph 5.4 and 5.5 of AS 3

Observation:

It was viewed that **only** the cash flows arising from ***purchase/sale of investments which are in the nature of available for sale and held for trading*** should be classified as 'Cash Flow from Operating Activities' and those acquired on account of sale/ purchase of 'held to maturity' investments should not be considered as cash flow from revenue generating activity of the bank due to its long term nature. Such activities are in the nature of investing activities and therefore should be classified as '***Cash Flow from Investing Activities***'.

Case:

In the note on Administrative and Other Expenses, there is an item ***Exchange Fluctuation (net)*** amounting to Rs. XXX, however, the same has not been adjusted to determine cash flow from operating activities in Cash Flow Statement.

Principle:

Paragraph 27 of AS 3

Unrealised gains and losses arising from changes in foreign exchange rates are not cash flows

Observation:

It was viewed that the entire amount cannot be considered to comprise of only realised foreign exchange gain/ loss unless such information has been provided. Hence, the ***unrealised foreign exchange loss should have been adjusted*** to determine cash flow from operating activities as per the requirements of AS 3.

Case:

In one of the enterprise, the ***components of Cash and Cash equivalents as reported in the balance sheet*** includes Cash in Hand, Cash at Bank, Earmarked Balance against LC, Gratuity & Superannuation etc., Unpaid Dividend Account, Interest accrued on Fixed Deposits and the total of these components matches with the closing cash & cash equivalents as reported in the cash flow statement.

Principle:

Paragraph 5.2 of AS 3

Observation:

It was observed that the balance of 'Cash and cash equivalents' as reported in the Cash Flow Statement is same as that in the balance sheet i.e. Rs. XXX. Further, it was noted from the **components of cash and cash equivalents** that it includes balances of unpaid dividend, accrued interest on FDs and earmarked balances against LC, Gratuity & Superannuation etc. which are not readily available with the enterprise for its use, thus, the same ***cannot be included*** in 'Cash and Cash Equivalents'.

Case:

The accounting policy on prior period adjustments states as follows:

"Prior period expenses and income are ***included in respective heads of expenses and income in the profit and loss account.***"

Principle:

Paragraph 15 of AS 5

Observation:

It was noted that as per the practice of the company the amount of prior period items had not been separately disclosed, whereas paragraph 15 of AS 5 requires that the nature and amount of prior period items should be ***separately disclosed in the statement of profit and loss in a manner that their impact on the current profit or loss can be perceived***. Thus, the policy regarding prior period item is not in line with the requirement of AS 5.

Case:

In the Annual Report of certain companies, the following items of income/expenses have been ***shown in the Statement of Profit and Loss under the head appropriations/ below the line***:

- Provision of earlier years taxation
- Write back of debts and sales tax dues

Principle:

Paragraph 5 of AS 5

Observation:

It was viewed that provision for earlier years taxation is an expense whereas write back of debts and sales tax dues is an income, ***both of which should be included in the determination of net profit for the period instead of showing them as appropriations/below the line***, which would result in overstatement/ understatement of current year's net profit. Further, it was not clear whether such liability or reversal thereof has arisen as a result of error/omissions in the preparation of financial statements of one or more prior periods in order to treat them as prior period items. Even if these items are considered as prior period items, these should be disclosed in the Statement of Profit and Loss in a manner that their impact on the current year's profit can be perceived as per the requirements of paragraph 15 of AS 5.

Case:

The significant accounting policy relating to construction contracts states as below:

"Job work revenue is accounted on the basis of running bills raised and approved by the clients. Revenue Expenditure is accounted on accrual basis as and when it is incurred."

Principle:

Paragraph 21 of AS 7

Observation:

It was observed that revenue has been recognised based on bills raised and cost has been accounted, as and when incurred, whereas paragraph 21 of AS 7 requires to recognise revenue and costs ***based on the stage of completion of the contract activity as on the reporting date***. Thus, the policy regarding construction contracts is not in line with the requirement of AS 7, Construction Contracts.

Case:

From the Annual Report of a company, it was noted that the company is ***involved in construction business and its Schedule of inventory also include an item of Job in progress***. However, no other disclosure was made in the financial statements.

Principle:

Paragraph 39 of AS 7

Observation:

It was observed that though involved in construction business, company had not made the following disclosures, as required by Paragraph 39 of AS 7:

(a) the aggregate amount of costs incurred and recognised profits (less recognised loses) up to the reporting date;

(b) the amount of advances received ; and

(c) the amount of retentions.

Accordingly, it was viewed that the company has not complied with the requirement of AS 7.

Case:

The accounting policy of revenue recognition as given in the Annual Report of a company inter alia states that ***revenue from online educational services (if charged) is recognised upon receipt of subscription fee (in case of non-refundable) otherwise apportioned over the subscription period***.

In the Annual Report of another company, the following accounting policy has been disclosed: "Revenue from online educational services is ***recognised upon receipt of subscription fees***. ..."

Principle:

Paragraph 7.1 of AS 9

Observation:

From the above, it was viewed that the period when services are rendered should be considered for recognition of revenue.

Accordingly, if revenue is received it should be deferred and ***recognised over the period when services are rendered***.

It was further viewed that the subscription fee for online educational services should be recognised apportioned over the service period.

Accordingly, it was viewed that the accounting policy followed in these cases is not in line with the requirements of AS 9

Case:

From the Annual Report of a company, it has been noted that the company has ***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 has been valued at net realisable value and insurance claim against the same is taken as other income. Insurance claim against loss of fixed assets has also been recognised based on the claim filed with the insurance company. The note further states said income has been recognised as per the AS 9.

Principle:

Paragraph 4.1 and 9.2 of AS 9

Observation:

It was noted that ***insurance claims do not fall within the definition of 'Revenue' as given in AS 9***. However, it was viewed that as in the case of sale of goods or rendering of services, the recognition of insurance claims also requires that the amount realisable is measurable and it is not unreasonable to expect ultimate collection. Accordingly, recognising insurance claims at the time of filing the claims with the insurance company without considering the uncertainty relating to its measurability is not appropriate.

Accordingly, it was viewed that ***recognition of revenue at the time of filing of claims is not in line with the principles of AS 9***.

Case:

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

Principle:

Paragraph 13 of AS 9

Observation:

It was observed that the dividend income has been recognised on receipt basis while paragraph 13 of AS 9 requires recognition of ***dividend income when the right to receive payment is established***.

Accordingly, it was viewed that the recognition of dividend income on receipt basis is not in line with the requirements of AS 9.

Case:

The following accounting policies on Revenue Recognition have been disclosed in the Annual Reports of some companies:

- Revenue (income) is recognised when no significant uncertainty as to measurability or collectability exists.
- Revenue/Income and Cost/Expenditure are accounted for on accrual basis.
- Sales are accounted for on dispatch of products.

Principle:

Paragraph 11 of AS 9

Observation:

It was observed in the first case that revenue has been recognised when there is no uncertainty as to measurability and collectability whereas in the second case it simply states accrual basis. However, in none of these cases the ***timing of recognition of revenue*** i.e. when the enterprise has transferred significant risk and reward to the buyer has been disclosed. In the last case also, it was not clear whether significant risk and rewards associated with the ownership of goods stands transferred when the products are dispatched.

Thus, it was viewed that the accounting policies for revenue recognition as disclosed in the financial statements are not in line with the requirements of paragraph 11 of AS 9.

Case:

From the Annual Report of a company, it has been noted that a significant amount has been shown as "Site & Land Development" during the year however no depreciation has been charged in respect thereof.

Principle:

Paragraph 18 of AS 10

Observation:

It was observed that paragraph 18 of AS 10 (Revised) specified ***directly attributable cost would also be included into the cost of fixed assets***. It may be noted that site preparation would be required for developing land as well as construction of building and installation of plant and machinery.

Accordingly, it was viewed that the site preparation costs comprising mainly of uprooting of any existing structure, leveling, clearing and grading incurred to prepare the land for its intended use or for construction thereon ***should be suitably apportioned to land, building and plant and machinery and capitalized as part of the costs of the respective assets as per the requirements of AS 10.***

Non - Compliance of Accounting Standards

AS 11 to 20

Case:

From the accounting policy given in the Annual Report of a Company, it was noted that the export sales have been recorded at the rate notified by the customs for invoice purposes.

Principle:

Paragraph 9 of AS 11

Observation:

It was noted from the stated accounting policy that the export sales have been recorded at the rate notified by the customs for invoice purposes ***instead of translating the same on the basis of exchange rate prevailing on the date of transaction***. This is not in line with the principles enunciated in paragraph 9 of AS 11.

Case:

It was observed from the accounting policy given in the Financial Statement of a company, that current assets and liabilities as at the end of the year are translated at exchange rate ruling on the date of Balance Sheet.

Principle:

Paragraph 11(a) of AS 11

Observation:

As per above referred requirement, it is **only the monetary items which are required to be translated at the closing exchange rate and not all the foreign currency assets and liabilities which may include non-monetary assets/ liabilities as well**. Accordingly, it was viewed that stated policy of translation of all current assets and liabilities at the year end exchange rate is not correct.

Case:

In the accounting policy of foreign exchange, it was stated that if foreign exchange transactions relates to acquisition of fixed assets, they are adjusted to the carrying cost of such assets.

Principle:

Paragraph 46A of AS 11

Observation:

It was noted from the stated accounting policy that the foreign exchange differences related to acquisition of any fixed asset are adjusted to the cost of such assets. It was viewed that such adjustment is permitted only if such exchange difference has ***arisen on long term foreign currency monetary items incurred for acquisition of a depreciable fixed asset***.

It was noted that in the given case neither the stated accounting policy nor the Balance Sheet indicates existence of any long term foreign currency monetary item. Hence, adjustment of any foreign exchange rate variation to the cost of fixed asset was not in line with the requirements of AS 11.

Case:

Grant received for depreciable assets has been recognized and disclosed as 'capital reserve' and subsequently transferred from capital reserve to statement of profit and loss.

Following are the examples of some of the accounting policies:

- *Grants and Capital subsidy from the government is credited to Capital Reserve. Further, in accordance with the guidelines issued by ICAI, proportionate amount to the extent of depreciation charged, is being transferred to surplus in the Statement of Profit and Loss in case of grant received in relation to acquisition of any assets.*
- *In case of depreciable assets, the cost of the asset is shown at gross value and grant thereon is taken to Capital Reserve which is recognized as income in the Statement of Profit and Loss over the useful life period of the asset.*

Principle:

Paragraph 14 of AS 12

Observation:

The subsidy received against a depreciable asset should either be shown as deduction from gross value of the asset to arrive at its book value or treated as deferred income which is recognized in the Statement of Profit and Loss on a systematic and rational basis over the useful life of the asset. Accordingly, above treatment of Government grant / subsidy is not in line with paragraph 14 of AS 12.

Case:

From the financial statements of certain companies it has been noted that they do not provide the accounting policy on employee benefits (including defined benefit plans) and in many of the cases reviewed by the FRRB, the disclosures required under Paragraph 120 were not given or partially given by the enterprises.

Principle:

Paragraph 119 and 120 of AS 15

Observation:

In majority of the cases it was observed that enterprises have ***not disclosed the basic information about the defined benefit plan*** as required under paragraph 119. Further, the ***description of defined benefit plan and accounting policy adopted for actuarial gains and losses including various other disclosures*** of paragraph 120 are, inter alia, the commonly found mistakes in the financial statements of enterprises.

Case:

Accounting policy on Valuation of Inventories states that –Finished goods are valued at lower of cost or net realisable 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.

Principle:

AS 2 and AS 16

Observation:

It was noted that interest cost was included in the cost of inventories. Para 12 of AS 2, 'Valuation of Inventories' provides that interest and other borrowing costs are usually considered as not relating to bringing the inventories to their present location and condition and are, therefore, usually not included in the cost of inventories. Para 5 of AS16, '***Borrowing Costs' provides that those inventories that are routinely manufactured or otherwise produced in large quantities on a repetitive basis over a short period of time, are not qualifying assets***. Accordingly, it was viewed that as per AS 16, no borrowing cost (interest) can be capitalized unless such inventories take a substantial period of time to get ready for sale. Thus there is a non compliance of AS 2 as well as AS 16.

Case:

Followings are the examples of accounting policies for capitalization of borrowing cost used by different companies:

- "Interest on borrowing for acquisition of qualifying asset is capitalized………."
- "Cost comprises of purchase price and other directly attributable costs of bringing the asset to its working condition for its intended use and includes interest on moneys borrowed for construction / acquisition of fixed assets upto the period the assets are ready for use.

Principle:

Paragraphs 19 of AS 16

Observation:

It may be noted from paragraph 19 of AS 16 that 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. However, in some cases, ***it has been observed that the stated accounting policies do not explicitly indicate*** **the point of time up to which such borrowing costs have been capitalized**. In the absence of such information, it is not clear whether borrowing costs have been capitalized only up to the date when the assets are ***ready for their intended use*** or thereafter.

Case:

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.*

Principle:

Paragraphs 3, 4(c) and 6 of AS 16

Observation:

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***. In fact, it involves revision in the terms of borrowings. Therefore, such costs are not eligible for capitalisation with the cost of asset.

Further, it was also viewed that, in any case, AS 16 does not prescribe amortisation of such costs. As such, the treatment followed by the company to defer such expenses is not in accordance with the requirements of AS16.

Case:

At times, neither the statement on significant accounting policies contain any accounting policy on Segment Reporting nor contain any segmental information.

Principle:

Paragraphs 38 of AS 17

Observation:

It was observed that ***in the absence of any information***, one may conclude that either despite the existence of reportable segments no segmental information has been disclosed or there are no reportable segments. Further, it was noted that explanation to Paragraph 38 of AS 17 requires that where the company has neither more than one business segment nor more than one geographical segment, then, the ***fact that there is only one 'business segment' and 'geographical segment' should be disclosed by way of the note.*** Thus, there is non-Compliance of AS 1 as well as AS 17.

Case:

Non disclosure of Related Party Transactions

Principle:

Paragraphs 23 of AS 18

Observation:

The following information/ transactions have been noted from Notes to Accounts, Cash Flow Statement, Director's Report, Corporate Governance Report given in the Annual Reports of different companies:

- 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;

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.

Case:

Asset has been acquired on finance lease, however, disclosure required under paragraph 22 with regard to asset under finance lease, not been made.

Principle:

Paragraph 22 of AS 19

Observation:

Accounting policy, on leased asset, of one of the company stated that "Rent in respect of leased equipment acquired under financial lease is charged to the Statement of Profit and Loss." It was observed that although the equipment have been acquired under finance lease, the ***disclosures as set out in Paragraph 22 have not been made in the financial statements.*** Accordingly, it was viewed that the requirements of paragraph 22 of AS 19 have not been complied with.

22. (a) Asset under finance lease to be ***segregated***

(b) For each class of asset net carrying amount

(c) Reconciliation between MLP as on BS date and carrying amount: Also break up of MLP in various period

(d) Contingent rent

(e) Total future MLP expected to be paid in sublease

(f) Description of significant leasing arrangements

Case:

- From the Annual Reports of few companies, it has been noted that significant expenses in the nature of rent and hire charges have been shown under Administration Expenses/ Other Expenses.
- In the Annual Reports of a couple of other companies, lease rentals and rent, including lease rentals, have been shown under operating expenses/overheads.
- It was noted from the financial statements of enterprises that although assets were acquired on non-cancellable lease, however, disclosures of paragraph 25 were not made.

Principle:

Paragraph 25 of AS 19

Observation:

It was observed that it is evident from the disclosures made in the financial statements, including notes to accounts, that these companies have taken certain assets under operating lease. However, disclosures required under paragraph 25 have not been made.

25. Asset under operating lease : disclosure by lessee

(a) Total future MLP classified in <1 year, 1-3 years, > 3 years (b) Total future MLP expected to be paid in sublease

(c) Lease payment recognised in PL (d) Sub lease payment received (e) Description of significant leasing arrangements

Non - Compliance of Accounting Standards

AS 21 to 29

Case:

The accounting policy relating to deferred tax states that "Deferred tax liability and asset are recognised, subject to the consideration of prudence, on timing differences using the tax rates substantively enacted on the Balance Sheet date."

Principle:

Para 15 of AS 22

Observation:

It has been noted from paragraph 15 of AS 22 that ***deferred tax assets should be recognised 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 realised. It has been noted that although the deferred tax asset has been recognised, 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 realised. Thus, the stated accounting policy with regard to recognition of Deferred Tax Assets is not complete.

Case:

The company has disclosed that deferred tax and current tax not recognised in the absence of book/ tax profit or losses.

Principle:

Para 13 of AS 22

Observation:

Paragraph 13 of AS 22 requires that "*Deferred tax should be recognised for all the timing differences, subject to the consideration of prudence in respect of deferred tax assets*".

Accordingly, deferred tax should be recognised for all the timing differences. As per clarification in response to Question 9 (ii), deferred tax liability recognised at the balance sheet date give rise to future taxable income at the time of reversal. Hence, deferred tax asset to the extent of deferred tax liability should be recognised.

Case:

A company had the ***carry forward of losses*** and its accounting policy with regard to Deferred tax , inter alia , states that "….The management is of the opinion that sufficient future taxable income will be available against which, such deferred tax assets will be realised……"

Principle:

Para 17 of AS 22

Observation:

Paragraph 17 of AS 22 requires that "*where an enterprise has unabsorbed depreciation or carry forward of losses under tax laws, deferred tax assets should be recognised only to the extent that there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available against which such deferred tax assets can be realised*".

It has been noted that the company had carried forward unabsorbed losses and as such Paragraph 17 was applicable. It was viewed that although the management was of opinion that the sufficient future taxable income will be available against which such deferred tax assets will be realised, however, it has ***failed to state that whether there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available.*** Accordingly, the stated accounting policy is not as per AS 22.

Case:

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.

Principle:

Para 29 of AS 22

Observation:

Paragraph 29 of AS 22 requires that "***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*".

Accordingly, it was viewed that the aforesaid presentation of DTA/ DTL is not in line with AS 22.

Case:

The deferred tax assets and liabilities had been presented in either of the manner as given below:

- Deferred tax liability shown as a part of ‘Loan Funds’.
- Deferred tax (net) shown after the head ‘Net Current Assets’.
- Deferred tax Liability is shown as a deduction from the ‘Application of Funds’.
- Deferred tax Liability is shown as a part of ‘Shareholders Funds’.
- Deferred tax Liabilities is shown as distinct sub-head under the Schedule of Provisions.

Principle:

Para 30 of AS 22

Observation:

Explanation to Paragraph 30 of AS 22 requires that ***deferred tax liabilities should be disclosed on the face of the balance sheet separately after the head ‘Unsecured Loans’ and deferred tax assets should be disclosed on the face of the balance sheet separately after the head ‘Investments’.***

Accordingly, it was viewed that the aforesaid presentation of DTA/ DTL is not in line with AS 22.

Case:

Certain companies do not disclose the break-up of the Deferred Tax Liability/ Deferred Tax Asset either in the schedule or notes to accounts.

Principle:

Para 31 of AS 22

Observation:

Para 31 of AS 22, Accounting for Taxes on Income, requires that “ *the break-up of deferred tax assets and deferred tax liabilities into major components of the respective balances should be disclosed in the notes to accounts.*”

Non disclosure of break-up of deferred tax assets or deferred tax liability is in contravention of AS 22.

Case:

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 amortised over the life of the concerned items.

Principle:

Paragraph 6.2 of AS 26

Observation:

- The expenditure incurred on rental paid for pre-commencement of retail stores, factories, seed marketing expenses, public/ capital issue expenses, preliminary expenses cannot be considered to be a 'resource' being controlled by the enterprise and hence, such expenses ***do not meet criteria of term 'asset'*** and therefore, they cannot be treated as asset. Accordingly, should be expensed as and when it is incurred.
- With regard to factory license fees, trade mark fees, these expenditure gives rise to intangible assets. Accordingly, they should be disclosed under the head of 'intangible assets' rather than 'deferred revenue expenditure'.
- 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', otherwise it should be expensed in the Statement of Profit and Loss in the year in which the expenditure is incurred.

Case:

The accounting policy of fixed assets given in the Annual Report of a company read as follows:

'Intangible assets are identified when they are expected to provide future enduring economic benefits. The assets are identified in the year in which the relevant asset is put to use. (emphasis added)'

Principle:

Paragraph 57 of AS 26

Observation:

As per aforesaid principle, internally generated asset can be capitalised and the capitalised cost, comprises expenditure that are directly attributable for making the asset ready for its intended use. However, in the given case the intangible assets are identified in the year in which the relevant asset is put to use. It was viewed that this is not in line with requirement of AS 26 which requires ***recognition with reference to the date when an intangible asset is available for use rather than when it is put to use***.

Case:

It was noted from the accounting policy on impairment that impairment loss has been determined on the basis of the net selling price which in turn has been derived based on the expected salvage value.

One of the notes forming part of Accounts given in the Annual Report of a company, stated as follows:

'The impairment loss had been determined ***on the basis of net selling price (determined on the basis of expected salvage value)*** *in respect of CGUs representing specific process plants and other individual assets. The impairment loss had been recognized owing to the prevalent market conditions of the product which was to be manufactured from specific process plants and conditions of the individual assets.*

Principle:

Paragraph 63 of AS 28

Observation:

It was observed that the term 'salvage value' is generally referred to as estimated value that an asset will realize upon its sale at the end of its useful life. It was viewed that as per requirement of AS 28, ***net selling price should be determined based on the value that can be obtained as on the Balance Sheet date which cannot be considered to be an end of useful life of an asset*** until and unless the assets would not be in use after the reporting date. Accordingly, it was viewed that ***considering expected salvage value for determining impairment loss is not in accordance*** with the requirements of AS 28.

Case:

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.'

Principle:

Paragraph 20 of AS 21

Observation:

It was noted from the given note that although the fact that the accounting policy followed by the subsidiaries in respect of investment, gratuity, depreciation/ amortisation etc. differ from that followed by the parent company has been disclosed, however, neither the ***proportion of these items in the consolidated financial statements to which these different accounting policies have been applied has been disclosed nor the fact that it is not practicable to do so has been mentioned***.

Case:

From the **"Related Party Disclosure" given in the Standalone Financial Statements, it has been noted that the company had acquired a subsidiary during the year**.
However, from the Consolidated Financial Statements, it was noted that the said subsidiary was neither consolidated nor information relating to it as a subsidiary was disclosed.

Principle:

Paragraphs 29(a) and 11 of AS 21

Observation:

It was noted from related party disclosure that the company had acquired a subsidiary during the financial year. It has also been noted that during the year, certain transactions have taken place with the said subsidiary company. However, the same was ***neither included in the list of entities, the financials of which have been consolidated nor any note providing the reasons for not consolidating the subsidiary*** was disclosed as required under paragraph 29(a) and paragraph 11 of AS 21 respectively.

Case:

Notes in Consolidated Financial Statement:
Other Income: Dividend income on Investment in Associates
Non-current Investments: Investment in Associates

Principle:

Paragraph 7 and paragraph 3.8 of AS 23

Observation:

It was viewed that in the absence of any information that such investments in associate falls under the exceptions as per paragraph 7, equity method of accounting should have been adopted for consolidating its results. Hence, ***company's share in the associate company's result of operation should have been recognised*** in Consolidated Statement of Profit and Loss instead of recognizing the dividend income on such investments.
Accordingly, it was viewed that ***neither the Consolidated Financial Statements have been prepared as per the equity method nor it has been stated that the associate company meets the prescribed exceptional conditions***. Accordingly, the requirement of AS 23 has not been complied with.

Case:

From the annual report of a company, it was noted that a list of all joint ventures as well as percentage of voting power of the company has been disclosed in the Consolidated Financial Statements. There was ***no such information available in Standalone Financial Statements.***

Principle:

Paragraph 49 and paragraph 52 of AS 27

Observation:

It was noted that disclosure regarding joint venture has been given under Consolidated Financial Statement. However, ***no such information has been provided in the Standalone Financial Statements*** as specifically required under paragraph 49 of AS 27.

Accordingly, it was viewed that the requirement of paragraph 49 of AS 27 has not been complied with.

(52. List of joint ventures and description of interest. For jointly controlled enterprise to disclose proportion of interest, name, country of incorporation)

Case:

In the Annual Report of a company, one of the note in Notes to Accounts stated as follows :

'In accordance with Accounting Standard 29, the following is considered as Contingent Liabilities: Guarantees given by bankers for performance of contracts & others.'

Principle:

Paragraph 10.4 of AS 29 and paragraph 8.8.7.2 of Guidance Note on Schedule III to the Companies Act, 2013

Observation:

It was noted that guarantees given by bankers for the performance of contracts have been disclosed as contingent liabilities of the company. It was viewed that ***guarantees given against own performance of the company do not give rise to any contingent liability*** because the company in any case holds an obligation to perform the event against which guarantee is given which is also supported by paragraph 8.8.7.2 of Guidance Note on Schedule III to the Companies Act, 2013.

Hence, ***such performance guarantees do not meet the definition of 'Contingent Liabilities' given in paragraph 10.4 of AS 29***.

Case:

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

Principle:

Paragraphs 12 of AS 29

Observation:

As per paragraph 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.

Case:

Noted in the Annual Report of a company:

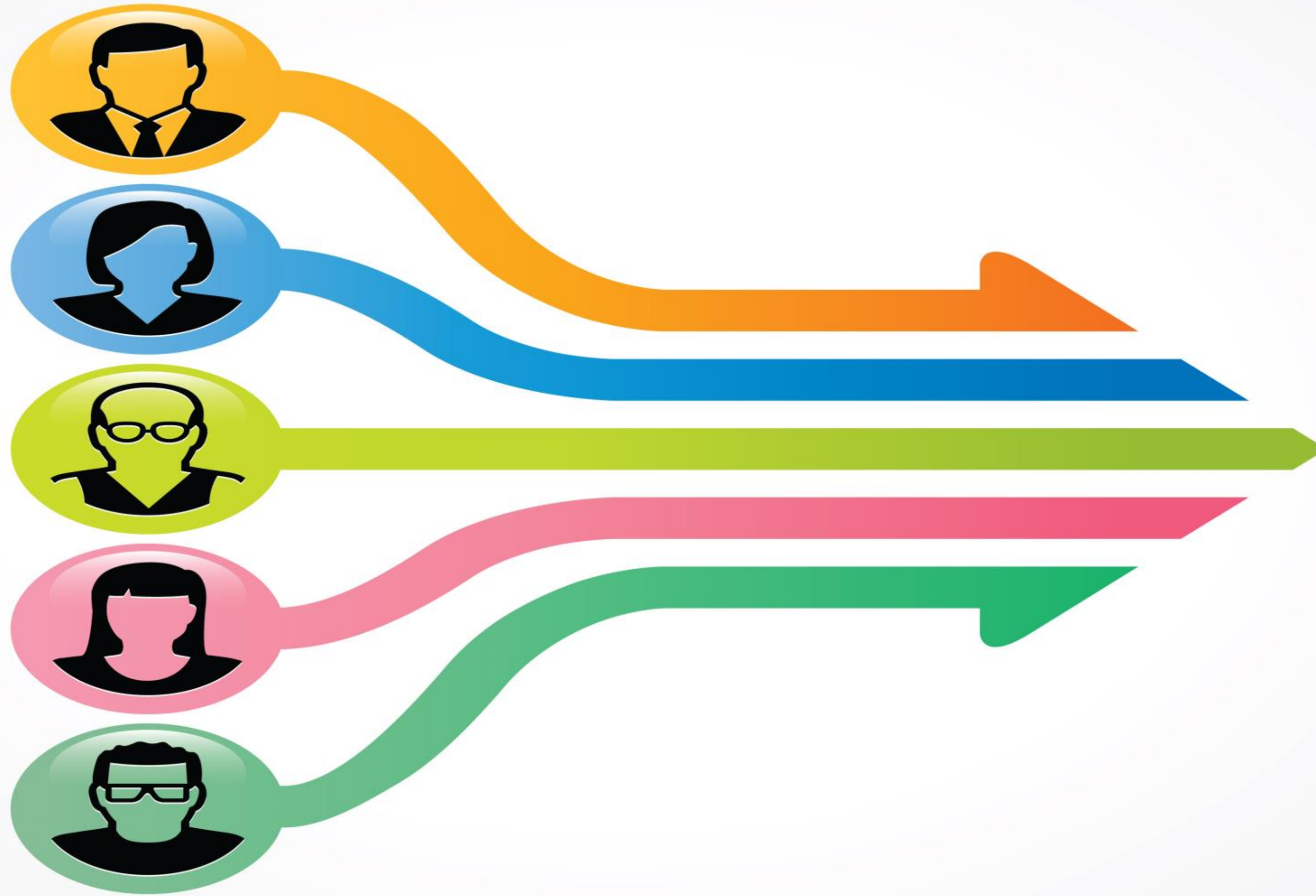
'The Company has not provided for moping up of subsidy on raw materials of fertilizer in terms of office memorandum issued by the Ministry of Chemicals & Fertilizers, Govt of India, which is being reconsidered and ***decided not to effect recovery till a policy in this regard is formulated. This has strengthened the management' view for not providing the same.'***

Principle:

Paragraph 68 and 71 of AS 29

Observation:

As per paragraph 71 of AS 29, where any of the information required by paragraph 68 is not disclosed because it is not practicable to do so, that fact should be stated. **While disclosing details of contingent liablities**, ***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.



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