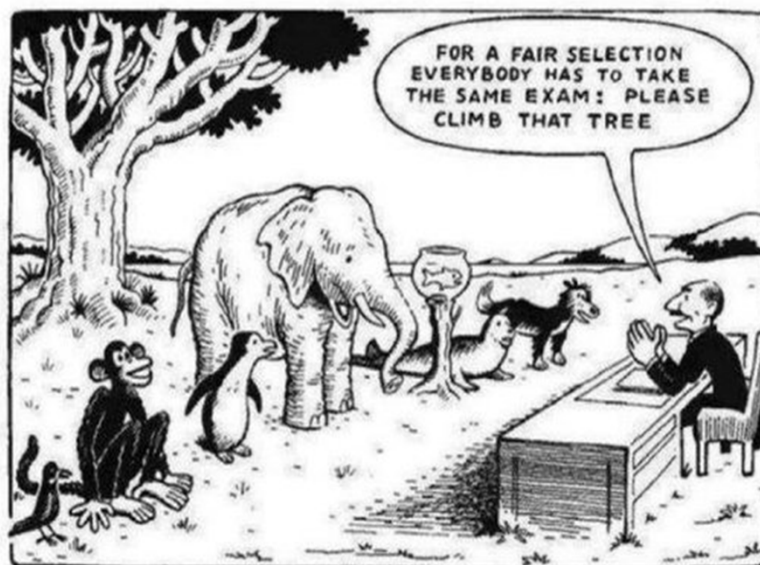


Audit Reporting and Common Mistakes therein

Organised
By
Western India Regional Council
Of
The Institute of Chartered Accountants of India

Presentation By
PARESH H. CLERK

November 22, 2014



Our Education System

2



REPORTING

SA 700 (REVISED)

Forming an Opinion and Reporting on Financial Statements

Scope...

- ❑ Deals with -
 - How to form an opinion?
 - ✓ Auditor's Responsibility
 - How to give a **clean** opinion in the Auditor's Report on the general purpose financial statements (FS) ?
 - ✓ Form and content

- ❑ Promotes:
 - Consistency
 - Credibility
 - Understanding

- ❑ Applies to :
 - Audits and not to reviews, compilations or agreed-upon procedures
 - Audits of 'general purpose FS' – FS prepared in accordance with a general purpose framework

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...Scope...

- ❑ **General purpose framework -**
 - Financial reporting framework designed to meet the common financial information needs of a wide range of users.
 - The financial reporting framework may be –
 - Fair presentation framework or
 - Compliance framework

- ❑ **Fair Presentation Framework...**
 - Where the auditor gives a true and fair report
 - Requires compliance with the requirements of the framework; and

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..Scope

❑ ...Fair Presentation Framework

- To achieve fair presentation of the financial statements, it may be necessary for management to :
 - Provide disclosures beyond those specifically required by the framework; or
 - Depart from a requirement of the framework (Only in extremely rare circumstances)

❑ Compliance Framework

- Where the auditor reports on whether FS comply with the requirements of the:
 - Applicable laws, or
 - Rules and regulations, or
 - Set of contractual terms and conditions
- Requires meeting the requirements of the framework but no freedom to the management

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Forming an opinion on FS...

- ❑ Whether the FS are prepared, in all material respects, in accordance with the applicable financial reporting framework
- ❑ The auditor is required to conclude that the FS as a whole are free from material misstatement whether due to fraud or error
- ❑ To reach to this conclusion, determine whether -
 - Sufficient appropriate audit evidence has been obtained
 - Uncorrected misstatements are, individually or in the aggregate, are material
 - Required evaluations have been carried out
 - Requirements of the reporting framework (e.g. Accounting Standards) have been materially complied with

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...Forming an opinion on FS...

- Management's judgements in preparing the FS are free from 'bias'
- Adequate disclosure of the accounting policies selected and applied
- Appropriateness and consistency of those accounting policies with the financial reporting framework
- Accounting estimates made by the management are reasonable
- Information presented in the FS is :
 - Relevant
 - Reliable
 - Comparable
 - Understandable

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...Forming an opinion on FS

- Adequate disclosures for users to understand the effect of material transactions and events
- Terminology used is appropriate
- The auditor shall evaluate whether FS achieve fair presentation - to that end also evaluate -
 - Overall presentation
 - Structure
 - Content
- Whether FS, including the related notes
 - Represent the underlying transactions and events in a manner that achieves fair presentation
 - Adequately refer to or describe the applicable financial reporting framework

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Form of Opinion

- ❑ **Unmodified Opinion :**
 - To express it when the auditor concludes that FS are prepared, in all material respects, in accordance with the applicable financial reporting framework
- ❑ **Modified Opinion (SA 705) :**
 - When the auditor concludes that, based on audit evidence obtained, though sufficient, FS as a whole are 'not free' from material misstatement(s); or
 - Due to non-availability of sufficient appropriate audit evidence not able to conclude that FS as a whole are free from material misstatement(s)
- ❑ If FS do not achieve fair presentation, auditor should discuss the matter with management to resolve the issue by:
 - Giving additional disclosures or,
 - Depart from the framework (in rare cases)
- ❑ Based on the outcome, decide whether he should give a modified opinion

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Report – Form and Content

- ❑ Paragraphs and order -

▪ Title	GENERAL SECTION
▪ Addressee	
▪ Introductory paragraph	
▪ Management’s responsibility paragraph	
▪ Auditor’s responsibility paragraph	RESPONSIBILITY AND OPINION PARAS
▪ Auditor’s opinion paragraph	
▪ Other responsibilities paragraph	
▪ Signature	OTHER MATTERS
▪ Date of the auditor’s report	
▪ Place of signature	

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Scope

☐ Title -

- ***INDEPENDENT AUDITOR'S REPORT***

☐ Addressee -

- It is usually addressed to those for whom it is prepared

"To the Members of ABC Company Limited"

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Announcements

- ☐ ICAI has suggested a few changes and made some amendments to the format of Independent Auditor's Report in SA 700, 705, and 706 by way of recent announcements
- ☐ Changes are in the light of notified Section 133 of the Companies Act, 2013 and changes in AS 11

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Sr. No.	Subject
1	Use of the term "Profit and Loss Account" or "Statement of Profit and Loss" in the Statutory Audit Reports of Companies
2	Reference to the Accounting Standards Applicable to the Companies in the Independent Auditor's Report and Limited Review Reports and various Engagements Standards
3	Statutory Auditor's Reporting Responsibilities in Respect of Depositing of Cess Pursuant to Clause 4(ix)(a) of the Companies (Auditor's Report) Order, 2003 and Section 227(3)(g) of the Companies Act, 1956
4	Manner of Reporting on Section 227(3)(bb) of the Companies Act, 1956 (Reporting on accounts of branch office)
5	Manner of Reporting In Respect of Such Clauses of the Companies (Auditor's Report) Order, 2003 which are not applicable to the Auditee Company
6	Amendment to the "Auditor's Responsibility" Paragraph included in the Independent Auditor's Report
7	Manner of Disclosure in the Auditor's Report of the fact of inclusion of Unaudited Financial Statements / Information of Component/s in the Financial Statements Audited by the Principal Auditor(s)
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Introductory Paragraph	
<ul style="list-style-type: none"> <input type="checkbox"/> Identify the entity <input type="checkbox"/> State – FS have been audited <input type="checkbox"/> Identify the title of each statement of FS <input type="checkbox"/> Specifies date or period covered <input type="checkbox"/> Now requires mention of "<i>summary of significant accounting policies and other explanatory information</i>" along with the identification of the various FS 	
<p>"Report on the Financial Statements -</p>	
<p>We have audited the accompanying financial statements of ABC Company Limited ("the Company"), which comprise the Balance Sheet as at March 31, 20XX, and the Statement of Profit and Loss/ Profit and Loss Account and Cash Flow Statement for the year then ended, and <u>a summary of significant accounting policies and other explanatory information</u>"</p>	
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Management Responsibility Paragraph

- ❑ Independent auditors do not share the responsibility for the preparation of FS
- ❑ **Management is responsible for the same**
- ❑ Previously this was given in a very concise form at the end of the introductory paragraph

"Management's Responsibility for the Financial Statements - Management is responsible for the preparation of these financial statements that give a true and fair view of the financial position, financial performance and cash flows of the Company in accordance with the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956/ *Accounting Standards notified under the Companies Act, 1956 read with General Circular 15/2013 dated 13th September, 2013 of the Ministry of Corporate Affairs in respect of section 133 of the Companies Act, 2013* ("the Act"). This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of the financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error"

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Auditor's Responsibility Paragraph...

- ❑ Responsibility of the auditor is to **express an opinion on the FS based on the audit**
- ❑ A key assertion that is made in this paragraph is that the audit was conducted in accordance with **the SAs**

"Auditor's Responsibility -

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement

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...Auditor's Responsibility Paragraph

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, *but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control*. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of the accounting estimates made by management, as well as evaluating the overall presentation of the financial statements

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion"

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Auditor's Opinion Paragraph

"Opinion -

In our opinion and to the best of our information and according to the explanations given to us, the financial statements give the information required by the Act in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India:

- (a) in the case of the Balance Sheet, of the state of affairs of the Company as at March 31, 20XX;
- (b) in the case of the Statement of Profit and Loss/ *Profit and Loss Account*, of the profit/ loss for the year ended on that date; and
- (c) in the case of the Cash Flow Statement, of the cash flows for the year ended on that date"

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Other Responsibilities Paragraph...

- ❑ This was previously placed before the Opinion Paragraph
- ❑ It gave the impression that auditors opinion is based on it which is not the same

"Report on Other Legal and Regulatory Requirements -

1. As required by the Companies (Auditor's Report) Order, 2003 ("the Order") issued by the Central Government of India in terms of sub-section (4A) of section 227 of the Act, we give in the Annexure a statement on the matters specified in paragraphs 4 and 5 of the Order

2. As required by section 227(3) of the Act, we report that -

(a) We have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit;

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...Other Responsibilities Paragraph

(e) On the basis of written representations received from the directors as on March 31, 20XX, and taken on record by the Board of Directors, none of the directors is disqualified as on March 31, 20XX, from being appointed as a director in terms of clause (g) of sub-section (1) of Section 274 of the Companies Act, 1956

~~(f) Since the Central Government has not issued any notification as to the rate at which the cess is to be paid under section 441A of the Companies Act, 1956 nor has it issued any Rules under the said section, prescribing the manner in which such cess is to be paid, no cess is due and payable by the Company"~~

(g) The report on the accounts of the branch offices audited under section 228 by a person other than the Company's auditor has been forwarded to us as required by clause (c) of sub-section (3) of section 228 and have been dealt with in preparing our report in the manner considered necessary by

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Signature

- Where the firm is appointed as auditor, the report is signed in the personal name of the auditor and in the name of the firm

*“For XYZ and Co.
Chartered Accountants
Firm’s Registration Number*

*Signature
(Name of the Member Signing the Audit Report)
(Designation)
Membership Number*

*Place of Signature
Date”*

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Announcement of January 4, 2014...

- **Manner of Reporting on Section 227(3)(bb) of the Companies Act, 1956 (Reporting on accounts of branch office)**

- To add under the “Report on Other Legal and Regulatory Requirements” Paragraph -
- “the report on the accounts of the branch offices audited under section 228 by a person other than the company’s auditor has been forwarded to us as required by clause (c) of sub-section (3) of section 228 and have been dealt with in preparing our report in the manner considered necessary by us”

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...Announcement of January 4, 2014...

- ❑ **Manner of Reporting in respect of such Clauses of the Companies (Auditor’s Report) Order, 2003 which are not applicable to the Auditee Company**
 - The auditor may aggregate the fact of non-applicability of different clauses of CARO, 2003 and report as under -
 - “Matters specified in clauses(relevant clause number of the clause/s not applicable) of paragraph of the CARO 2003 do not apply to the Company.”

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...Announcement of February 10, 2014...

- ❑ **Manner of Disclosure in the Auditor’s Report of the fact of inclusion of Unaudited Financial Statements / Information of Component/s in the Financial Statements Audited by the Principal Auditor(s)**

Materiality of component/s to FS of entity/ consolidated FS of group and whether they are audited or unaudited	Disclosures in the Principal Auditor’s Report
<u><i>Situation 1</i></u> Unaudited and not material	<ul style="list-style-type: none"> • May or may not disclose the fact • If disclosed, then it will have to be shown under the “Other Matters” paragraph as per SA 706
<u><i>Situation 2</i></u> Audited other than Principal Auditor and not material	

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...Announcement of February 10, 2014

Materiality of component/s to FS of entity/ consolidated FS of group and whether they are audited or unaudited	Disclosures in the Principal Auditor's Report
<i>Situation 3</i> Audited other than Principal Auditor and material	Disclosure to be made under "Other Matters" in the Principal's Auditor's Report as per SA 706
<i>Situation 4</i> Unaudited and material	Consider the impact on the auditor's opinion on the FS of the entity/ consolidated FS

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Issues

- ❑ How should an auditor frame his opinion where a statute or court order allows an entity to prepare financial statements without meeting a GAAP requirement ? Say, permitted to account certain type of income or expenditure on cash basis
 - ✓ The auditor should ***not modify*** his opinion
 - ✓ **State** it in the "***Emphasis of Matter***" paragraph about the modified framework

- ❑ How should the auditor's opinion be expressed if the financial statements are prepared in accordance with two financial reporting frameworks ?
 - ✓ **Issue two separate opinions**, in either two different sentences or in a single sentence
 - ✓ If they are in compliance with one framework but not the other, an unmodified opinion may be given on the former and a modified opinion on the latter

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SA 705

Modifications to the Opinion in the Independent Auditor's Report

Scope

- ❑ Deals with Audit Reports where a Modification to the auditor's opinion is necessary
- ❑ A modified opinion is necessary when -
 - The auditor concludes, based on the audit evidence obtained, that the **FS as a whole are not free from material misstatement; or**
 - The auditor is **unable to obtain sufficient appropriate audit evidence** to conclude that the FS as a whole are free from material misstatement

Types of Modified Opinion

- **Qualified Opinion -**
 - When the auditor concludes that misstatements, individually or in the aggregate, are material, but not pervasive

- **Adverse opinion -**
 - The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both, material and pervasive to the FS

- **Disclaimer of an Opinion -**
 - When the auditor is unable to obtain sufficient appropriate audit evidence and concludes that the possible effects on the FS of undetected misstatements, if any, could be both material and pervasive

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Summary of Modified Opinions

<u>Nature of the Matter</u> (giving rise to the Modification)	<u>Auditor's Judgement</u>	
	<i>Material but Not Pervasive</i>	<i>Material and Pervasive</i>
FS are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

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'Basis of Modified Opinion' Paragraph

- ❑ The Auditor's Report shall include a paragraph of the heading -
 - "Basis for Qualified Opinion"
 - "Basis for Adverse Opinion", or
 - "Basis for Disclaimer of Opinion"
- ❑ This paragraph is placed above the Opinion Paragraph
- ❑ The auditor shall include in this paragraph, a description and quantification of the financial effects of the misstatement, unless impracticable

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Qualified Opinion

Basis for Qualified Opinion

"As stated in Note XX, Schedule XX the Company has paid Rs. XX lakhs as remuneration to managing and other directors, which is in excess of the limits prescribed under the Companies Act, 1956. Had the Company accounted for the remuneration in accordance with law, the loss after tax for the year would have been lower and loans and advances would have been higher by ` XX lakhs."

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Adverse Opinion

Basis for Adverse Opinion

“As explained in Note X, the Company has not consolidated the financial statements of subsidiary XYZ Company it acquired during 20XX because it has not yet been able to ascertain the fair values of certain of the subsidiary’s material assets and liabilities at the acquisition date. This acquisition is therefore accounted for as an investment.

Under the accounting principles generally accepted in India, the subsidiary should have been consolidated because it is controlled by the Company. Had XYZ been consolidated, many elements in the accompanying financial statements would have been materially affected. The effects on the financial statements of the failure to consolidate have not been determined.”

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Disclaimer of Opinion

Basis for Disclaimer of Opinion

“(a) We have not been able to obtain sufficient appropriate audit evidence with regard to the recoverability of Sundry Debtors, particularly having regard to:

- (i) the aggregate amount of debtors outstanding for a period exceeding six months being Rs. XXX .
- (ii) debtors in respect of sales during the period aggregating ` XXX being fully unrecovered, and (iii) the debtors outstanding at the commencement of the financial year aggregating Rs. XXX being yet to be recovered to the extent of Rs. XXX.

(b) There was also a limitation of scope on the audit carried out by us since while observing the physical verification of stock-in trade carried out by the Management during the period, individual items aggregating Rs. XXX per the books of account were not produced to us for physical verification. Accordingly, we were precluded from fully performing our audit procedures in this regard.”

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'Modified Opinion' Paragraph...

- ❑ Where opinion is modified, the paragraph is titled as -
 - "Qualified Opinion"
 - "Adverse Opinion" or
 - "Disclaimer of Opinion"
- ❑ In case of Qualified Opinion, due to material misstatement the auditor shall state -

"except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements have been prepared, in all material respects, in accordance with the applicable financial reporting framework when reporting in accordance with a compliance framework."

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...'Modified Opinion' Paragraph

- ❑ When the modification arises from an inability to obtain sufficient appropriate audit evidence, the auditor shall use the phrase "except for the possible effects of the matter(s)..."
- ❑ When the auditor expresses an adverse opinion, he shall state –

"because of the significance of the matter described in the Basis for Adverse Opinion paragraph the financial statements have not been prepared, in all material respects, in accordance with the applicable financial reporting framework when reporting is in accordance with a compliance framework."

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'Auditor's Responsibility Paragraph'

- ❑ In a qualified or adverse opinion, the auditor shall state that -

"the audit evidence obtained is sufficient and appropriate to provide a basis for the auditor's modified audit opinion."

- ❑ In case of a disclaimer of opinion, the auditor shall state that -

"Because of the matter(s) described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion."

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Issues...

- ❑ If the management imposes a scope limitation after the auditor has accepted the engagement, what should he do?
 - ✓ Auditor shall request that management remove the limitation
 - ✓ If management refuses to do so, the auditor shall communicate the matter to TCWG and determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence

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...Issues...

- ❑ If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall determine that -
 - If the undetected misstatements, could be material but not pervasive, the auditor shall qualify the opinion;
 - If the possible effects of undetected misstatements, could be both material and pervasive, the auditor shall:
 - Resign from the audit, where practicable and not prohibited by law or
 - If resignation from the audit is not practicable or possible, disclaim an opinion on the Financial Statements

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...Issues

- ❑ There is a misstatement or a series of misstatements in the FS that the auditor evaluates as material and pervasive. The auditor explains each misstatement in separate paragraphs in his report and then states in his opinion that 'subject to the matters stated in the said paragraphs, the FS give a true and fair view'... Is this permissible?
 - ✓ No, the auditor would have to give an adverse or a disclaimer of an opinion
- ❑ What is an auditor obligated to do if he expects to modify his report?
 - ✓ The auditor has an obligation to communicate this to 'Those charged with Governance' that he intends to do so
 - ✓ Also to provide them the proposed wording

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SA 706

Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report

Scope

- ❑ Deals with -
 - Form and content of
 - Emphasis of matter paragraphs and
 - Other matter paragraphs in the Independent Auditor's Report
 - Matters that are already appropriately presented or disclosed in the financial statements

- ❑ Refers to a matter appropriately presented or disclosed in the FS that, in the auditor's judgement, is of such importance that it is fundamental to users' understanding of the FS

Emphasis of Matter Paragraph...

- ❑ It does not make the opinion “modified”
- ❑ It is not a :
 - Substitute for either the auditor expressing a qualified opinion or an adverse opinion, or disclaiming an opinion
 - Part of the audit opinion at all, instead it is a separate, independent paragraph designed to provide “additional communication” to the users
- ❑ Requirements –
 - Given **immediately after the opinion paragraph**;
 - Has a heading “Emphasis of Matter”
 - It must provide a reference to the matter being emphasised and where, in the FS, that matter in its elaborated form is to be found; and
 - Contains a declaration that the auditor’s opinion is not modified in respect of the matter emphasised

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...Emphasis of Matter Paragraph

Suggested Disclosure

“We draw attention to Note XX of Schedule XX to the financial statements stating that the Company has paid Rs. XX Crores under protest against claims of Rs. XX Crores for expenses which the Company has disputed in matters that are in various stages of litigation. Pending resolution of these disputes by the relevant courts, these expenses have been accounted for in the financial statements based on the management’s expectation of the amounts due. Our opinion is not qualified in respect of this matter.”

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Other Matter Paragraph

- ❑ Required to enhance users' understanding of an audit

If the other matter pertains to the audit, the auditor's responsibility or the auditor's report insofar as	Where placed in auditors report?
Expressing an opinion on the financial statements	Placed immediately below the Emphasis of Matter paragraph
Other reporting responsibilities of the auditor (e.g., reporting under CARO)	Included in the section titled: "Report on Other Legal and Regulatory Requirements"

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Issues

- ❑ Whether Basis for Qualified Opinion paragraph to be stated in bold or italics?
 - ✓ SA 705 **doesn't require to highlight the modification**. However, if the applicable statute requires the auditor to highlight the same, it should be so presented
 - ✓ Thus, **for audits under the Companies Act, 1956 the qualification will have to be presented in bold or italics**, however, no such requirement under the Companies Act, 2013

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Modification / Additional Reporting requirement under the Companies Act, 2013...

Companies Act, 1956

Section 227(3) - The auditor's report shall also state:

Clause (a)

Whether he has obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purposes of his audit

Companies Act, 2013

Section 143(3) - The auditor's report shall also state:

Clause (a)

Whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements

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...Modification / Additional Reporting requirement under the Companies Act, 2013...

Clause (h) :

Any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith

Clause (i) :

Whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls;

Clause (j) :

Such other matters as may be prescribed

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...Modification / Additional Reporting requirement under the Companies Act, 2013

Draft Rule 10.8 : Views and comments on –

- ❑ Whether the company has -
 - Disclosed the effect of any pending litigations on its financial position in its financial statement
 - Made provision for foreseeable losses on long term contracts, including derivative contracts
 - Delayed in depositing money into the Investor Education and Protection Fund by the company

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**Commonly found Errors
in the
Auditor's Report and
Annexure to the
Auditor's Report**

Auditor's Report on the Financial Statements...

Observations/ Suggestions...

- ❑ Reference was to the Cash Flow Statements in the Introductory Paragraph, but nothing was expressed on the true and fair view of the same
 - ✓ Para 10 of SA 700 – Auditor to form an opinion on the true and fair view of the financial statements which includes Cash Flow Statement as per Para 7

- ❑ Opinion Paragraph does not indicate the financial reporting framework used in the preparation of the financial statements
 - ✓ Para 35 – Indicate the financial reporting framework used in the preparation of the financial statements

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...Auditor's Report on the Financial Statements...

...Observations/ Suggestions...

- ❑ Membership number was neither mentioned in the Auditor's Report nor in the Annexure to the Auditor's Report
 - ✓ Para A36 states to mention the membership number

- ❑ No reference was given to the significant accounting policies and other explanatory information in the introductory paragraph
 - ✓ Para 23 – the introductory paragraph shall refer to the significant accounting policies and other explanatory information

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...Auditor's Report on the Financial Statements...

...Observations/ Suggestions...

- ❑ Auditor's Responsibility paragraph did not specify about the:
 - Compliance with the ethical requirements
 - Reasonable assurance obtained as to whether the FS are free from material misstatement

- ✓ Para 30 – Explanation shall be given that the Standards on Auditing require:
 - Auditor's compliance with ethical requirements
 - Auditor plans and performs the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement

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...Auditor's Report on the Financial Statements...

...Observations/ Suggestions...

- ❑ The auditor has signed the report prior to the date of signing of the Financial Statements
 - ✓ Para 41 – The date shall not be earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements, including evidence that:
 - Financial statements, including the related notes, have been prepared

- ❑ Basis for Qualified Opinion paragraph is not given in italics
 - ✓ Appendix to SA 705 requires the paragraph to be in italics

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...Auditor's Report on the Financial Statements...

...Observations/ Suggestions...

- ❑ Opening paragraph states to have "examined the attached Balance Sheet..."
 - ✓ Examined signifies greater Auditor's responsibility compared to his actual responsibility.
 - ✓ Para A17 of SA 700 suggests to report opening paragraph as "We have audited the attached Balance Sheet of..."

- ❑ Report was not addressed to anyone
 - ✓ Para 22 of SA 700 – "The auditor's report should be appropriately addressed as required by the circumstances of the engagement and applicable laws and regulations."

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...Auditor's Report on the Financial Statements

...Observations/ Suggestions

- ❑ "We have audited the attached Balance Sheet of X Ltd. As on March 31, 20XX and Profit and Loss Account for the year ended on that date annexed thereto. These financial statements are the responsibility of the Company's Management..."
 - ✓ Para 26 – Describe management's responsibility for the preparation of the financial statements
 - ✓ Para 29 – Auditor's responsibility is to express an opinion on the financial statements based on the audit
 - ✓ The report shall satisfy both of the above requirements

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Companies (Auditor's Report) Order (CARO), 2003...

Clause 4 (i)(b)...

Observations

- " The Management has conducted physical verification of the fixed assets during the year and we are informed that discrepancies noticed were not material."

- "Physical verification of the fixed assets is covered under a scheme of verification over a period of three years. No serious discrepancy was noticed on such verification during the period."

- ✓ Specify about the reasonableness of physical verification

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...Companies (Auditor's Report) Order (CARO), 2003...

Clause 4 (iii)...

Observations/ Suggestions

- "The Company has not taken/ granted any loans, secured or unsecured from/ to Companies, firms or other parties listed in the register maintained under Section 301 of the Companies Act, 1956, except loans granted on current account to its subsidiaries, the rate of interest and terms and conditions were not prima-facie prejudicial to the interest of the Company."
- ✓ Specify about regularity of receipt/ payment of the principal / interest amount

- Non - disclosure about the number of parties from/ to whom loans are taken/ given and the amounts involved

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...Companies (Auditor's Report) Order (CARO), 2003...

Clause 4 (iv)...

Observations/ Suggestions

- "In our opinion and according to the information and explanations given to us, there are adequate ~~internal control procedures~~ internal control system commensurate with the size of the company and nature of its business with regard to the purchase of inventory and fixed assets."
 - ✓ Specify about services and continuing failure to correct major weaknesses

- "The Company does not have any inventory, therefore, the question of ~~reporting does not arise.~~"
 - ✓ There was stock-in-process, hence the above reporting is in contravention with CARO provisions

November 22, 2014

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...Companies (Auditor's Report) Order (CARO), 2003...

Observation

□ Clause 4(v)(a)

Legal and professional fees paid to a firm in which the director is interested but CARO states, " According to the information and explanations provided by the management, there has been no contract or arrangement the particulars of which are required to be entered into the register maintained under section 301 of the Companies Act, 1956."

□ Clause 4(vi)

Auditor has reported on the compliance with the provisions of Sections 58A and 58AA of the Companies (Acceptance of Deposits) Rules, 1975 but has omitted to state other relevant provisions of the Act and Rules framed thereunder

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...Companies (Auditor's Report) Order (CARO), 2003...

Observation/ Suggestions

Clause 4(viii)

- Investment in plant and machinery and turnover as at the end of immediately preceding financial year exceeds Rs. 1 crore and Rs. 10 crores respectively, however, CARO states, "As informed to us, the Central Government has not prescribed maintenance of cost records by small scale industry unit..."

Clause 4(x)

- "As per records of the Company, the accumulated losses of the Company are more than fifty percent of its net worth. The Company has incurred cash losses during the current financial year."
 - ✓ Reporting also to be done for immediately preceding financial year

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...Companies (Auditor's Report) Order (CARO), 2003...

Clause 4(ix)...

Observations

- "The company is regular in depositing undisputed statutory dues including Provident fund, investor education and protection fund, employees state insurance, income tax, sales tax, wealth tax, custom duty, excise duty, Cess and other statutory dues with the appropriate authorities. Late deposit if any has been reported in the Form 3CD attached." **[Clause 4(ix)(a)]**
- On commenting on disputed statutory dues/ regularity of depositing undisputed statutory dues, although the amount has been mentioned, but the companies have not specified about the name of the statute, nature of amount due and period to which it relates **[Clause 4(ix)(a)/(b)]**

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...Companies (Auditor's Report) Order (CARO), 2003...

Observation/ Suggestions

□ Clause 4(xv)

"According to the information and explanations given to us, the Company has not given any guarantee for loans taken by its ~~subsidiaries and associates~~ from banks or financial institutions."

- ✓ Comments have to be on "others" and not restricted to subsidiaries and associates

□ Clause 4(xvii)

"According to the information and explanations given to us and on an overall examination of the Balance Sheet of the Company, we report that temporary short-term funds have been used for long-term investment."

- ✓ Nature and amount to be indicated

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...Companies (Auditor's Report) Order (CARO), 2003

Clause 4(xxi)

Observation/ Suggestions

□ "According to the information and explanations given to us, no fraud on or by the company has been noticed or reported ~~during the course of our audit~~ during the year."

□ "In our opinion and according to the information and explanations given to us, no fraud on or by the company has been noticed or reported during the year, that causes financial statements to be materially misstated."

- ✓ If frauds occur, they do not materially misstate the FS. Hence, using the words "materially misstated" could be interpreted that only frauds that misstates FSs will have to be reported
- ✓ In case of fraud, the nature and amount involved should be indicated

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Commonly found Errors in the Financial Statements

AS 1 : Disclosure of Accounting Policies...

Observations/ Suggestions...

Basis of Preparation

- "The accounts are prepared on the basis of going concern under historical cost convention as also accrual basis and in accordance with the ~~Accounting Standards notified by ICAI~~ Accounting Standards referred to in Section 211 (3C) of the Companies Act, 1956, which have been prescribed by the Companies (Accounting Standards) Rules, 2006, *(which continue to be applicable in respect of Section 133 of the Companies Act, 2013 in terms of General Circular 15/2013 dated September 13, 2013 of the Ministry of Corporate Affairs)* and the relevant provisions of the Companies Act, 1956/*the Companies Act, 2013, as applicable.*"

...AS 1 : Disclosure of Accounting Policies

...Observations/ Suggestions

- Omit to disclose policies such as:
 - Borrowing costs
 - Valuation of inventories
 - Impairment of assets

- Disclosure for change in accounting policies
 - Not appropriately disclosed with quantitative impact

- Contingent Liabilities
 - Disclosed under various notes instead at one place

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AS 2 : Valuation of Inventories...

Observations/ Suggestions...

- Method of Valuation
 - "Stores, Spares and Packing Materials; Raw Materials and Components and Finished Goods-in-transit have been valued at cost."
 - "Finished goods have been valued at cost or market value, whichever is lower."
 - ✓ "Raw materials, packing materials, stores and spares, furnace oil and fuel are valued at cost or net realisable value, whichever is lower/ items are considered to be realisable at cost, if the finished products, in which they will be used, are expected to be sold at or above cost."

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...AS 2 : Valuation of Inventories...

... Observations/ Suggestions...

Cost Formula

- "The cost formula used is either FIFO or ~~Specific Identification Method~~, as applicable."
- "Raw materials, store and spares and work-in-progress are valued at the lower of cost and the net realisable value."
 - No cost formula was mentioned
- ✓ "Cost comprises basic cost (net of CENVAT and VAT, if any) and other costs incurred in bringing them to their respective present location and condition. Cost is determined on a Weighted Average basis."

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...AS 2 : Valuation of Inventories...

... Observations/ Suggestions...

Provision for Excise Duty and Components of cost

- "Excise duty on the finished goods lying in factory premises and not cleared from excise bonded warehouse has not been provided and hence not included in inventory valuation. However, there is no effect on profit or loss for the year on the account of above treatment of excise duty."
 - Components of cost not disclosed clearly
- ✓ Cost includes all direct costs and a proportion of other fixed manufacturing overheads based on normal operating capacity. Excise duty on finished goods awaiting clearance has been provided for and included in cost thereof. Cost is determined on a Weighted Average basis

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...AS 2 : Valuation of Inventories

...Observations/ Suggestions

Inter divisional transfer

- "Stock of materials sold by one unit to other is ~~valued at transfer price~~ works/ factory Costs of the transferor unit/ division, plus transport and other charges."

Others

- Use of words "as taken, valued and certified by the management" in the Note of inventories should be avoided

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AS 3 : Cash Flow Statements...

Observations/ Suggestions...

Disclosure...

- Shown as cash flows from :
 - ▶ Financing activities
 - ▶ Interest received – Investing Activity
 - ▶ Fixed deposits with banks - Investing Activity
 - ▶ Net proceeds from borrowings - Investing Activity
 - ▶ Investing activities
 - ▶ Increase in share capital – Financing Activity
 - ▶ Operating activities
 - ▶ Interest paid - Financing Activity
 - ▶ Foreign exchange variations shown as an extraordinary item – Operating/ Financing Activity depending on the facts of each case

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...AS 3 : Cash Flow Statements...

...Observations/ Suggestions...

□ ...Disclosure

- Purchase/Sales of Investments and Advance given to Subsidiaries disclosed on a net basis
 - ✓ Separate disclosure should have been made reflecting both under the 'investing activities'

- Certain disclosures made in the Statement of Profit and Loss but not disclosed in the CFS
 - Eg., Amounts written off/ written back, unrealised exchange fluctuation gains/ losses

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...AS 3 : Cash Flow Statements

...Observations/ Suggestions

□ Cash and cash equivalents

- Cash and Cash Equivalents include deposits with maturity over twelve months
 - ✓ Deposits, is more than three months cannot be considered as a cash equivalent

- Amount of significant cash and cash equivalent balances- not disclosed separately
 - ▶ Dividend account
 - ▶ Unclaimed Debenture and Interest
 - ▶ Margin money account
 - ▶ Fixed deposit which is under lien with banks
 - ✓ Separate note is required where certain amounts are earmarked against specific liabilities

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

Observations/ Suggestions...

In Significant Accounting Policies

- “It is the Company’s Policy to take into account the impact of any significant event that occurs after Balance Sheet date but before the ~~finalisation of accounts~~ date of approval of the financial statements by the Directors.”
- “Discounts, claims, and rebates payable are accounted as and when settled.”
- “Liability in respect of warranty cost is reckoned in the year in which the liability is incurred.”
 - ✓ Liability of warranty cost arises on sale of products, hence, provision should be made at the time of sale

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

... Observations/ Suggestions

In Additional Notes

- “No provision in respect of claim liability of the company for the year ended 31.03.20XX has been made as the company has decided to charge the payment only when the liability is finally ~~settled and paid~~ incurred.”
- Disputed Taxes (though paid) or claim which is not yet settled - not disclosed as Contingent Liabilities

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

Observations/ Suggestions...

Prior Period Items/ Change in Estimate...

- Change of estimate is not :
 - ▶ Prior period item
 - ▶ Extraordinary item
- "Prior period expenses and income are included in respective heads of expenses and income in the profit and loss account."
- ✓ Nature and amount of prior period items to be disclosed separately to ascertain their impact on the Statement of Profit and Loss

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

...Observations/ Suggestions...

...Prior Period Items/ Change in Estimate...

- Adjustments related to previous period but determined in current period e.g. wage settlement arrears, treated as prior period items

Exceptional/ Extraordinary Items...

- Reversal of provision made in earlier years treated as an Extraordinary Item for :
 - Investment in shares
 - Gain on sale of company's medical equipment business unit
- ✓ Nature of the exceptional/ extraordinary items should have been explained

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

...Observations/ Suggestions

□...Exceptional/ Extraordinary Items

- "Superintendent Central Excise Range, X vide Y dated Z raised a demand on the company for Rs. X for service tax in respect of goods transportation and commissioning on clearing and forwarding for the period 16/11/20XX to 02/06/ 20XX. The company has paid the same and shown as an extra ordinary expenditure in the current year."
- ✓ The above being an ordinary business, service tax paid should be treated as an ordinary activity

- Nature of expenses not explained for 'Unamortised Miscellaneous Expense written-off' and 'Unamortised Expenses'

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AS 6 : Depreciation Accounting...

Observations/Suggestions...

- Rate of depreciation different from the Companies Act, 1956...
 - "Depreciation on fixed assets has been calculated on Straight Line Method on pro-rata basis at the rates specified in Schedule XIV of the Companies Act, 1956. However, in case of plant and machineries, higher depreciation rates have been charged based upon the residual useful life."
 - ✓ Useful life/ Higher rate of depreciation should be mentioned in case where different rates are used
 - ✓ "Depreciation on assets installed/acquired after April 2, 1987 is provided pro-rata on straight line method at the rates and on the basis specified in Schedule XIV to the Companies Act, 1956. However, motor cars have been depreciated at X % p.a...."

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...AS 6 : Depreciation Accounting...

... Observations/Suggestions...

- ...Rate of depreciation different from the Companies Act, 1956
 - "Assets acquired up to a certain date are depreciated as per ~~Income Tax~~ rates specified in Schedule XIV of the Companies Act, 1956."

- No depreciation/amortisation charged on :
 - Leasehold Land
 - Right of Use [ROU]
 - Plant & Machinery for shut down period

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...AS 6 : Depreciation Accounting

... Observations/Suggestions

- Different basis for depreciation
 - "Depreciation is being calculated on straight line method based upon the rates and in the manner specified in Schedule XIV (as amended) of the Companies Act, 1956 and on the amount added on revaluation, depreciation is provided on residual life as estimated by the valuers."
 - ✓ On revaluation, depreciation charged on the revalued amount and estimate of the remaining useful lives applying separate rates for additional and original amount is not in compliance with AS 6

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AS 9 : Revenue Recognition...

Observations/Suggestions...

Export Incentives and exchange fluctuations

-Revenue from sale of products is inclusive of excise duty and export incentives.”
 - ✓ Export incentives is not a consideration arising from sale of goods, hence they should be disclosed as a separate line item

- “Sales revenue is recognised when property in the goods with all significant risks and rewards associated with the ownership are transferred to the buyer, at a price and includes exchange fluctuation in case of an export.”
 - ✓ Exchange fluctuation is not a cash inflow, hence it does fall within the scope of the definition and should be excluded

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...AS 9 : Revenue Recognition...

... Observations/Suggestions ...

Point of Recognition

- “Revenue is recognised when ~~no significant uncertainty~~ transfer of significant risks and rewards as to determination and realization exists.”

Dividend

- “Long Term Investments are stated at cost. Dividends are accounted for ~~as and when received~~ when right to receive payment is established”

Inter-divisional transfers/ Captive Consumption

- Recognising them as sales is not in line with AS 9

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...AS 9 : Revenue Recognition

...Observations/Suggestions

- Commission, cash discounts and rebates
 - "... revenue from sale is recognised net of incentive on sales from commission, rebates and discounts."
 - ✓ The above items should be considered as expenses instead of deducting it from the sales
 - ✓ Discount – specify whether it is trade or cash discount

- Excise duty
 - Difference in excise duty on opening and closing stocks of finished goods is disclosed in the Note on materials consumed
 - Sales including excise duty-shown on the face of the Statement of Profit and Loss and excise duty-shown as an expense in the Schedule 'Manufacturing, Administrative and Selling Expense'

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AS 10 : Accounting for Fixed Assets...

Observations/Suggestions...

- Revaluation
 - An amount from Revaluation Reserve was transferred to Other Income in the Profit and Loss Account
 - ✓ Transferred amount – to be shown separately
 - An amount was added on account of revaluation of assets in total amount of assets
 - ✓ Value of individual assets should also be revised

- Classification...
 - Income tax and wealth tax paid is treated as pre-operative expenses
 - ✓ Income tax and wealth tax arises only after the commercial production commences, hence treating it as pre-operative is incorrect

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...AS 10 : Accounting for Fixed Assets...

...Observations/Suggestions...

□ Classification...

- Classification of fixed assets – often ‘Intangible assets’ not shown separately
 - ✓ Disclosure : Intangible Assets
 - Internally Generated
 - Others

□ Capitalisation...

- Enabling assets/Assets not owned recognised as fixed assets e.g. capitalisation of development of road on land not owned by the company and depreciation provided on the same

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...AS 10 : Accounting for Fixed Assets...

...Observations/Suggestions...

□ Capitalisation...

- “Major revenue expenditure incurred by way of/ in connection with planned replacement of worn out parts of plant and equipments is amortised over the estimated period, the benefit from such expenditure is expected to endure.”
 - ✓ Revenue expenditure – should not be capitalised
- “Leasehold land represents amount paid to State Industrial Development Corporation for land to be purchased on 95 years lease, for which compliance with certain conditions as mentioned in the license agreement and registration is pending as on date.”
 - ✓ Land to be treated as an asset only on purchasing/possessing it

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...AS 10 : Accounting for Fixed Assets

... Observations/Suggestions

□ ...Capitalisation

- "Fixed assets are stated at cost net of cenvat/ VAT and include amount added on revaluation less accumulated depreciation and impairment loss, if any. All cost is inclusive of freight, duties (net of tax credits as applicable") levies and any directly attributable cost till ~~commencement of commercial production~~ date the asset is ready for its intended use."

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AS 11 : The Effects of Changes in Foreign Exchange Rates...

Observations/ Suggestions...

□ Gain/ Loss

- "Current Assets and Current Liabilities are converted at the forward exchange contract rates wherever taken or at the exchange rates prevailing at the year end. The resultant gain or loss is ~~recognised under the revenue heads of accounts~~ charged to the Statement of Profit and Loss."
- Gains/Loss on derivatives / hedging adjusted to carrying cost of Fixed Assets which is not in accordance with ICAI Announcement on 'Accounting for Derivatives' unless it is covered by Para 46/ 46A of AS 11
- "The unrealised loss on outstanding derivative contracts had not been recognised in the books."

✓ Such use of words should be avoided

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...AS 11 : The Effects of Changes in Foreign Exchange Rates...

... Observations/ Suggestions ...

Premium

- "...The company has fully hedged the foreign currency risk on the borrowing including interest through forward rate contracts. The premium amortised during the year is Rs.X which is included in 'Other Finance Charges'. The net exchange difference on forward contract and on loan liability of the stated ECB has been adjusted in 'Interest on Term Loan and Deposits' schedule."

- ✓ "In case of forward contracts, the exchange difference between the forward rate and the exchange rate at the date of transaction is recognised as an income or expense over the life of the contract."

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...AS 11 : The Effects of Changes in Foreign Exchange Rates

... Observations/ Suggestions ...

Initial Recognition

- "Current Assets / Current foreign currency transactions are recorded at the exchange rates prevailing ~~on the date of settlement~~ at the date of the transaction or at the ~~year-end rate~~ date of the transaction whichever is applicable."

- "Foreign currency assets and liabilities are converted at the rate prevailing on the last day of the accounting year and transactions completed during the year are accounted for at the ~~then ruling rate~~ date of the transaction."

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AS 13 : Accounting for Investments...

Observations/ Suggestions...

Diminution

- "Current investments are valued at the lower of cost and fair value and Long-term investments are valued at cost. Provision is made for any ~~permanent~~ diminution other than temporary in the value of investments."

Classification...

- Only one figure was reported under the head 'Other Income' instead of bifurcating into dividend and interest income
 - ✓ Dividend and interest income – Show them as separate line items

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...AS 13 : Accounting for Investments...

...Observations/ Suggestions...

...Classification

- Investments are classified as :
 - ▶ Long term Investments
 - ▶ Trade Investments
- "Investments are stated at the cost of acquisition. Provisions for diminution in the value of Investments are made only if such decline is other than temporary, in the opinion of the management."
 - ✓ Bifurcation between current and long term investments should be made
- Cost was considered at ~~FIFO~~ Weighted Average Amount

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...AS 13 : Accounting for Investments

...Observations/ Suggestions

Disclosure

- Investment in shares in wholly owned subsidiary was shown as NIL since amount due against it was unpaid as on the reporting date which was adjusted against the cost of shares
 - ✓ Investment should appear at cost in the FS and the liability against it should be accounted for separately
- Not disclosed distinctly :
 - ▶ Aggregate amount of quoted/ unquoted investments
 - ▶ Market value of quoted investments
 - ▶ Valuation adopted
- No accounting policies disclosed for investments made in units, bonds, shares, etc.

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AS 15 : Employee Benefits (revised 2005)...

Observations/ Suggestions...

Disclosure

- Non-disclosure of details :
 - ▶ Experience adjustments
 - ▶ Plan assets
 - ▶ Expected contribution for the next year
- "Provision towards liability for gratuity is made on the basis of actuarial valuation and is charged to revenue. Liabilities in respect of gratuity of employees is ascertained on the basis of actuarial valuation and paid to the gratuity fund."
 - ✓ Detailed disclosure to be made as per para 120

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98

...AS 15 : Employee Benefits (revised 2005)...

...Observations/ Suggestions...

Termination Benefits...

- Expense under voluntary retirement scheme is being written off over a period of 5 years
 - ✓ Termination benefits to be immediately expensed out

- Contributions to Provident Funds set up and managed through Trusts established by employers not being classified as defined benefit obligation
 - ✓ Para 5 – Trust to be considered as defined benefit obligation

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...AS 15 : Employee Benefits (revised 2005)...

...Observations/ Suggestions...

Termination Benefits

- "Contributions to the Government Provident Fund and ESI are charged to revenue. Since the company does not have any defined retirement benefit scheme in this regard, AS 15 issued by ICAI is not considered applicable."
 - ✓ At least, a provision for gratuity should be made in case of employees who are in service

Valuation...

- "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."
 - ✓ At least, a provision for gratuity should be made in case of employees who are in service

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...AS 15 : Employee Benefits (revised 2005)

...Observations/ Suggestions

□...Valuation

- "The liability in respect of Leave Encashment on retirement and Post Retirement Medical Benefits is based on the ~~internal calculation~~ Projected Unit Credit Method of the management."
- "Leave encashment benefit is accounted for on a cash basis."
- "Gratuity fund is administered through the scheme of insurance companies and the contribution to the above fund is charged against revenue."
 - ✓ Charge to revenue should be based on actuarial valuation and not on the basis of premium paid to the insurance companies

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AS 16 : Borrowing Costs...

Observations...

□Disclosure

- "Fixed Assets are stated at cost less accumulated depreciation. All expenses incidental to the purchase/ construction/ installation and commissioning including financial charges are added to the cost of fixed assets."
 - The above is disclosed in Fixed Asset's accounting policy but no separate policy is disclosed for borrowing cost
- Accounting policies are disclosed but amount capitalised was not disclosed

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...AS 16 : Borrowing Costs...

...Observations/ Suggestions...

Inventories

- "Finished goods are valued at the lower of cost or net realisable value; costs include depreciation, interest (excluding interest on discounting of bills) and direct expenses to the point of stocking, excise duty but excludes administration and selling expenses."
- ✓ Inventory should not include borrowing costs unless it takes substantial time to get ready for sale

Incorrect capitalisation

- Capitalising interest cost for an asset which was neither purchased nor possessed. From the minutes, it was found that the asset was supposed to be sold

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...AS 16 : Borrowing Costs...

...Observations/ Suggestions...

Restructuring Charges/ Liabilities

- "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."
 - ✓ The above charges do not fall within the definition, hence it should have been expensed out whenever they were incurred
- Restructured liabilities are adjusted against company's general reserves
- ✓ Liabilities on restructuring are additional restructuring borrowing expenses which should be expensed

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...AS 16 : Borrowing Costs

... Observations/ Suggestions

Prepayment

- "Premium on prepayment/ resetting of interest liability on term loans are amortised over the remaining repayment period of the respective loans."
- ✓ Amount paid for prepayment is not for facilitating loans, hence they do not fall within the definition

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AS 18 : Related Party Disclosures...

Observations...

Managing Director

- Managing director's name (who had the authority and responsibility for planning, directing and controlling the company's activities) was not disclosed under AS 18 as 'Key Management Personnel'
- Managerial remuneration paid to the directors but not disclosed under AS 18 disclosure

Disclosure...

- Investment made in Joint venture reported in Corporate Governance report but it is not disclosed under AS 18 disclosure

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...AS 18 : Related Party Disclosures

... Observations/ Suggestions

...Disclosure

- Names of the related parties and nature of their relationships and transactions were not mentioned

- Nature and value of RPT are disclosed on an aggregate basis, but individual party-wise disclosure of material transactions was not made

Materiality

- "...There were no material individual transactions with related parties during the year, which were not in the normal course of the business as well as at arm's length basis..."
- ✓ Disclose details of the related parties irrespective of the materiality of their transactions

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AS 20 : Earnings Per Share...

Observations...

Disclosure

- EPS is neither shown on the face of the Statement of Profit and Loss nor in the Notes

- Non-disclosure of :
 - ▶ Diluted EPS
 - ▶ Nominal value of shares

Denominator

Following were not considered :

- Excess tax provision of earlier years recognised in the current year
- Weighted average number of shares (only year-end balance was considered)

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...AS 20 : Earnings Per Share

...Observations/ Suggestions

Value

- Basic and diluted EPS stated at the same value (although warrants which were issued were considered as dilutive)
- Negative EPS was disclosed as NIL
 - ✓ EPS should be disclosed as negative and not as NIL

Changes after Balance Sheet Date and before BOD's approval

- Bonus shares issued after the Balance Sheet date but before the approval of FSs were not considered for EPS computation
 - ✓ Changes taking place between the Balance Sheet date and approval by the Board of Directors – calculations to be based on the new number of shares

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AS 22 : Accounting for Taxes on Income...

Observations...

Disclosure...

- Deferred Tax Assets and Liabilities had been presented as a part of :
 - Loan Funds
 - Net Current Assets
 - Shareholders Funds
 - Note of Provisions
 - ✓ Deferred tax liability – After the head 'Unsecured Loans'
 - ✓ Deferred tax asset – After the head 'Investments'
- Separately disclosed :
 - ▶ Advance tax paid as 'Current Assets, Loans and advances'
 - ▶ Provision for income tax as 'Current Liabilities and Provisions'
 - ▶ Deferred tax asset on the asset side
 - ▶ Deferred tax liability on the liability side

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...AS 22 : Accounting for Taxes on Income...

...Observations...

- ❑ ...Disclosure
 - Accounting policy on accounting for Deferred Tax Assets had not been disclosed
- ❑ Break-up
 - No break-up of DTA/ DTL was shown
 - Break-up was shown with respect to the balances that were reflected in the Statement of Profit and Loss
 - ✓ Break-up – Show it with respect to the balances shown in the Balance Sheet
 - Current and deferred tax was clubbed and shown under the head 'Provision for Taxation'
 - ✓ Clearly distinguish between current and deferred tax, hence, show them as separate line items

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...AS 22 : Accounting for Taxes on Income

...Observations/ Suggestions

- ❑ Offsetting DTA and DTL
 - In the Consolidated Balance Sheet, deferred tax asset and liability of the holding and subsidiary company was offset against each other
 - ✓ HC and SC does not have a legal enforceability right and hence, amounts cannot be offset against each other
- ❑ Certainty
 - Difference between 'Reasonable Certainty' and 'Virtual Certainty' often overlooked and DTA created on C/F Losses without ascertaining Virtual Certainty backed by convincing evidence

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AS 26 : Intangible Assets...

Observations/ Suggestions...

Wrong depreciation rate

- "Costs incurred towards purchase of computer software are depreciated on written down value method pro-rata to the period of use of assets, at the annual depreciation rates stipulated in Schedule XIV to the Companies Act, 1956." –
- ✓ No such depreciation rate is given for computer software in Schedule XIV of the Companies Act, 1956

Assets not owned

- "...Modifications that enhance the operating performance or extend the useful life of fixed assets used but not owned by the company are also capitalised, where there is certainty of deriving future economic benefits from the use of such assets."
- ✓ Assets not owned do not meet the "asset" criteria, hence it cannot be treated as an asset

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...AS 26 : Intangible Assets...

...Observations/ Suggestions...

Miscellaneous Expenditure

- Expenses incurred towards IPO and other deferred expenses classified as Miscellaneous Expenditure written off equally over a period of 5 years
- ✓ Share issue expenses – to be expensed out
- Amalgamation/ preliminary/ share issue/ miscellaneous expenses have been capitalised under the head of 'Deferred revenue expenditure' and amortised over a period of 3-5 years
- ✓ Relocation/ reorganisation expense – to be expensed out
- Deferred Employee Compensation included under Miscellaneous Expenditure on the face of the Balance Sheet

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...AS 26 : Intangible Assets

...Observations/ Suggestions

Amortisation

- Store opening fees was being amortised over a period of five years which is not in accordance with AS 26. Further, the nature of store opening fees was also not explained anywhere in the financial statements
 - Amortisation period for brands and goodwill is stated as 20 years, but no reasons for the same were stated in the FSs
 - ✓ If intangible assets is amortised over more than 10 years, specify the reasons for such a presumption
 - Expenditure on research and development is not separately allocated and identified in the Statement of Profit and Loss

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AS 29 : Provisions, Contingent Liabilities and Contingent Assets...

Observations/ Suggestions

- "The company has not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier."
 - ✓ Amount of warranty – Make a provision
 - ✓ Amount of reimbursement – Treat it as a separate asset
- Disclosures required as per Para 67 is not made by many companies
- Disputed dues shown as contingent liabilities but is not reflected under clause 4(ix)(b) of CARO

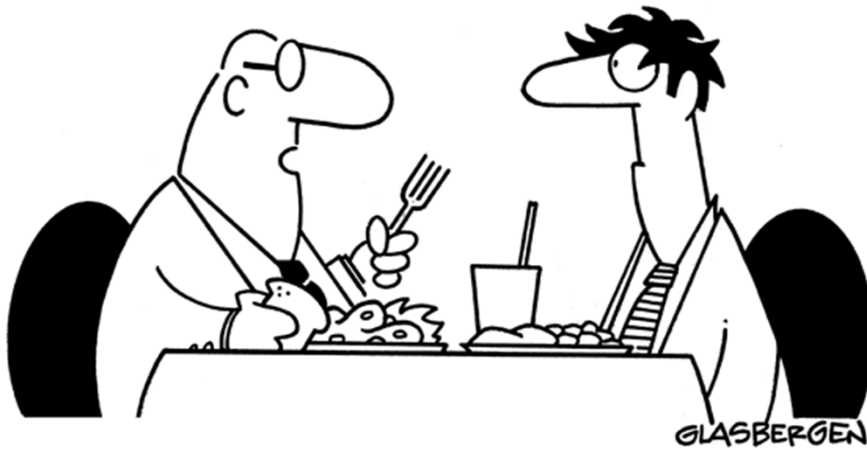
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**"I'm successful in business because I'm lucky.
But I didn't get lucky until I started working 90 hours a week!"**