Accounting Standards:

A Company Audit Perspective

CA. AMAL PAUL, FCA, DISA, DipIFR

Part I: Financial Reporting Framework and applicable Standards

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Whether the Companies are required to follow AS issued by ASB of ICAI?

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Whether the Companies are required to follow AS issued by ASB of ICAI?

The Companies are required to follow AS as notified under Section 133 of the Companies Act, 2013.

While providing all notes, reference should be made to the “AS notified under the Act” instead of “AS issued by ASB of ICAI”

As part of audit procedure, do you verify the applicable financial reporting framework every year?

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At each reporting date, it is to be ensured whether the Company is required to follow AS or Ind AS.

If the Company is not following applicable financial reporting framework, we cannot say that the financial statements reflects a true and fair view.

Whether the Companies are required to follow AS notified under Companies (AS) Rules, 2006 now?

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The Companies (AS) Rules, 2006 were replaced by Companies (AS) Rules, 2021.

While preparing and auditing the financial statements, it should be ensured that the reference is given to the 2021 rules.

Do you have a mechanism to check whether your client is an SMC or Non-SMC?

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As per Companies (AS) Rules, 2021, an SMC should satisfy all the following conditions:

1. Not listed/ in the process of listing in India or outside India
2. Not a Bank, financial institution or insurance company
3. Revenue from operations does not exceed 250 crores in preceding year
4. Borrowings (including public deposits) does not exceed 50 crores at anytime during preceding year and
5. Not a holding/ subsidiary of a Non-SMC.

Does the notes to accounts contains a note stating that client is an SMC and availing the exemptions?

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The AS Rules states that if a Company is SMC and it is availing the exemptions applicable for SMCs, it should be appropriately disclosed. The following note should be included in the notes to accounts:

“The Company is a small and medium sized company (SMC) as defined under Companies (Accounting Standards) Rules, 2021 notified under the Companies Act, 2013. Accordingly, the Company had complied with the Accounting standards applicable to a Small and Medium sized Company.”

Whether an SMC is required to take actuarial valuation while accounting for defined benefit plans like gratuity?

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Whether an SMC is required to take actuarial valuation while accounting for defined benefit plans like gratuity?

An SMC should determine and provide for accrued liability actuarially using Projected Units Credit Method.

However, the detailed disclosures specified under the standard is not mandatory for an SMC.

Whether diluted EPS disclosure is applicable for SMC?

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Whether diluted EPS disclosure is applicable for SMC?

Disclosure regarding Diluted EPS (both before and after extra-ordinary items) is exempted for SMCs.

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Whether SMCs are required to provide disclosures like segment reporting and related party disclosures?

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SMCs are exempted from AS 17 Segment Reporting in its entirety.

AS 18 Related Party Disclosures are applicable to SMC in its entirety.

Whether SMCs are required to recognise deferred tax?

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Whether SMCs are required to recognise deferred tax?

No relaxation is provided for SMC in relation to AS 22.

AS 22 is applicable in its entirety.

The provisions regarding deferred tax is exempted only for micro non-company entities (Level IV)

Whether SMCs are required to comply with the provisions of AS 28?

Whether SMCs are required to comply with the provisions of AS 28?

AS 28 is applicable to SMCs.

However, while computing value in use for impairment review, they are permitted to take a reasonable estimate using a method other the present value technique.

Further, they are exempted from certain disclosures also.

Part II: Common non-compliances related to AS (including FRRB comments)

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AS 2 - Valuation of Inventories

- The accounting policies adopted for measuring the inventories including cost formula to be disclosed.

- Exchange difference on settlement/ restatement of trade payable does not form part of cost of inventories.

- Inventories should not be stated as "as taken, valued and certified by the Directors/ Management".

AS 3 - Cash Flow Statements

- The adjustments regarding all non-cash income or expenses should be made while computing operating cash flows using indirect method.

- A small company is not required to present cash flow statement. However, the status should be verified at each reporting date.

- Disclosure of components of cash and cash equivalents should be made along with reconciliation to equivalent item presented in Balance Sheet.

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

- All income or expense should be routed through P&L unless it is as permitted by another AS. No direct adjustment to reserves.
- No deferred revenue expenditure is permitted.
- Prior period items should be disclosed separately. It should be not be included within other income/ other expenses/ extra-ordinary items/ exceptional items.

AS 7 - Construction Contracts

- Outcome of a construction contract can be measured reliably for a real-estate developer only if at least 25% of contract cost is incurred (GN on real estate transactions).

AS 9 - Revenue Recognition

- Revenue from rendering of service should be recognised either by using proportionate completion method or completed service contract method. Its application should be ensured.

- The revenue recognised should not include tax or any amount collected on behalf of third parties.

- In case of agency service, the commission only represents the revenue.

AS 10 Property, Plant and Equipment

- The disclosures should use the term “Property, Plant and equipment” instead of tangible fixed assets.
- It is to be ensured that whether any provision for dismantling/ decommissioning/ site restoration is required for any PPE.
- Component approach should be followed for depreciation for material assets.
- Documentary proof regarding review of useful life, depreciation method, residual value should be obtained.

AS 10 Property, Plant and Equipment

- Depreciation should commence from the date on which it is available for use.
- Accounting treatment for the replacement of part should be followed.
- Profit/ (loss) on disposal/ derecognition is shown under other income/ other expenses. If it is material, it may be shown as exceptional item.

AS 11 - The Effects of Changes in Foreign Exchange Rates

- The foreign currency monetary items should be restated using closing rate even if the actual settlement had happened before the finalisation of accounts.

- If any forward contract is entered into for a monetary item, the hedged item and hedging instrument should be accounted for separately.

- Any exchange gain/ loss should be recognised as other income/ other expenses. Exchange difference should not be classified as finance cost unless criteria under AS 16 is met.

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AS 15 - Employee Benefits

- Provisions for gratuity is required even if employees are yet to complete the vesting condition of 5 years.
- Provision for leave encashment, statutory bonus etc. to be provided for.
- The classification of defined contribution plan and defined benefit plan should be thoroughly verified.
- Whole-time directors/ MD are employees and their remuneration should be classified as Employee benefit expenses.
- Provision will be required for those obligations which arise from informal practices.

AS 16 - Borrowing Costs

- The accounting policy for borrowing costs is to be included in the significant accounting policies.
- The amount of borrowing cost capitalised during the year should also be disclosed.

AS 17 - Segment Reporting

- Segment reporting is not mandatory for SMC.
- The primary reporting format should be identified based on relevance.
- The secondary reporting requirements should also be appropriately disclosed.

AS 18 - Related Party Disclosures

- The related party information should not contradict with other notes.
- Related party disclosures are mandatory for all companies.

AS 19 - Leases

- The disclosures applicable for operating leases should be incorporated if you are having rental expenses in Profit & Loss.

- The lease classification should be appropriately made.

AS 20 - Earnings Per Share

- EPS computation should be specifically verified if there is a share issue during the year.
- Diluted EPS is not mandatory for SMC.
- If the Basic EPS and Diluted EPS are same, it can be presented in a single line item.
- Nominal value of share also to be disclosed along with EPS.

AS 22 - Accounting for Taxes on Income

- Offsetting of current tax assets and current tax liabilities.
- The tax computation and the Profit and Loss should be thoroughly compared to identify the timing differences.
- The break-up of major components of deferred tax assets and liabilities should be disclosed.
- DTA should be recognised only if there is a reasonable certainty/ virtual certainty for carried forwarded losses.
- While accounting for MAT Credit entitlement, the guidance note should be complied with.

AS 26 - Intangible assets

- Due care should be made while accounting for internally generated intangible assets.
- If expenditure on research and development phase cannot be distinguished, entire amount should be expensed off.
- Preliminary expenses, pre-operating cost cannot be capitalised.
- The useful life of intangible assets cannot exceed 10 years.

AS 28 - Impairment of Assets

- It should be evaluated whether there is an indication for impairment for any assets as at year-end. Documentation in this regard to be obtained.

- Impairment test is mandatory for intangible assets under development at each reporting date.

AS 29 - Provisions, Contingent Liabilities and Contingent Assets

- The pending legal cases should be thoroughly verified to identify whether a provision is required.
- Disclosure regarding contingent liability should include those obligations for which amount cannot be measured reliably also.
- Provision is required for obligations even if full amount is refundable. Reimbursement asset can be recognised only if the receipt is virtually certain.

Thank you

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