

Application of Accounting Standards in Practice

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Applicable Financial Reporting Framework

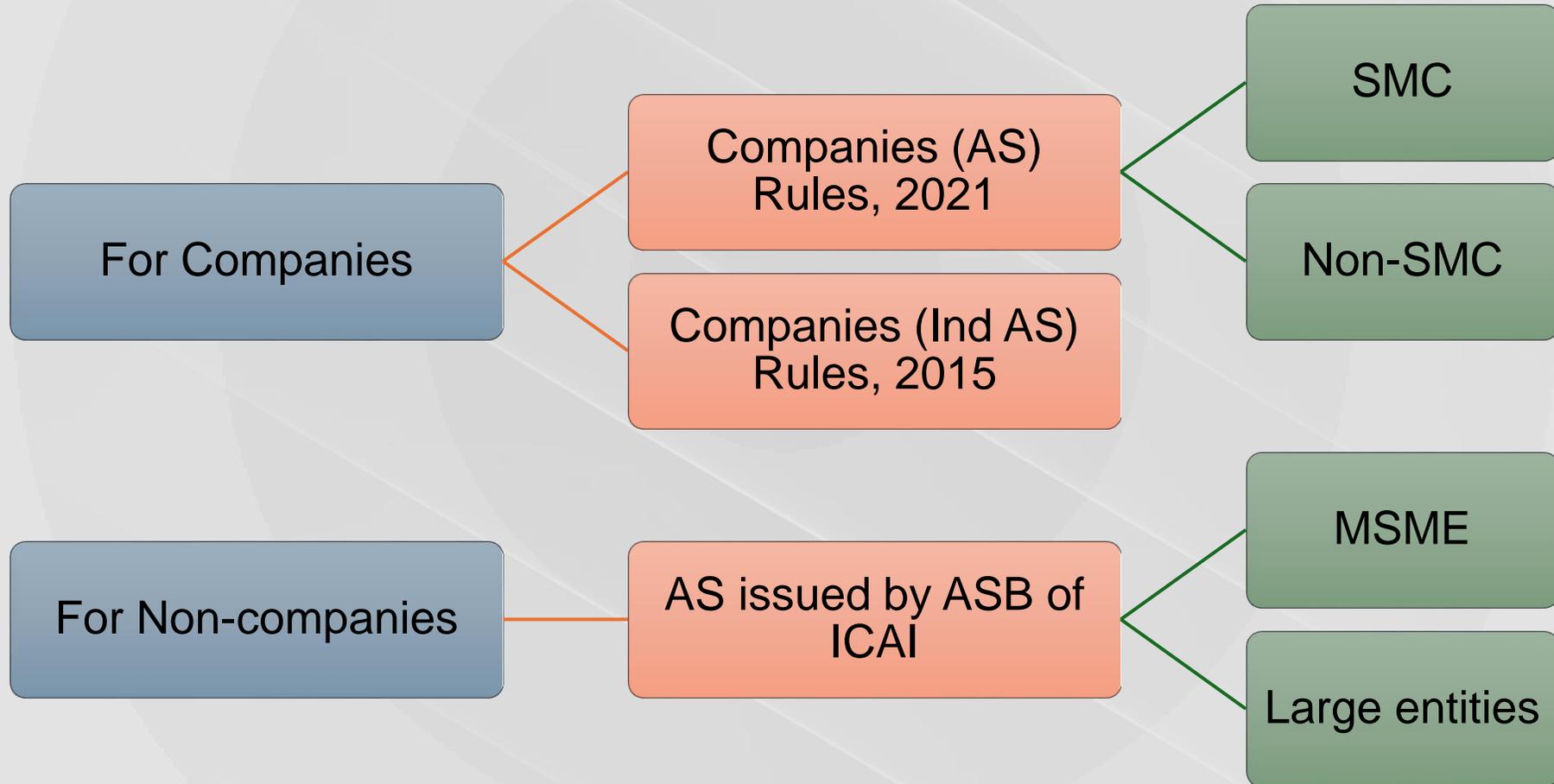
Let's discuss...!

APM is a trust which has been formed for charitable purpose and necessary registrations are also obtained from Government.

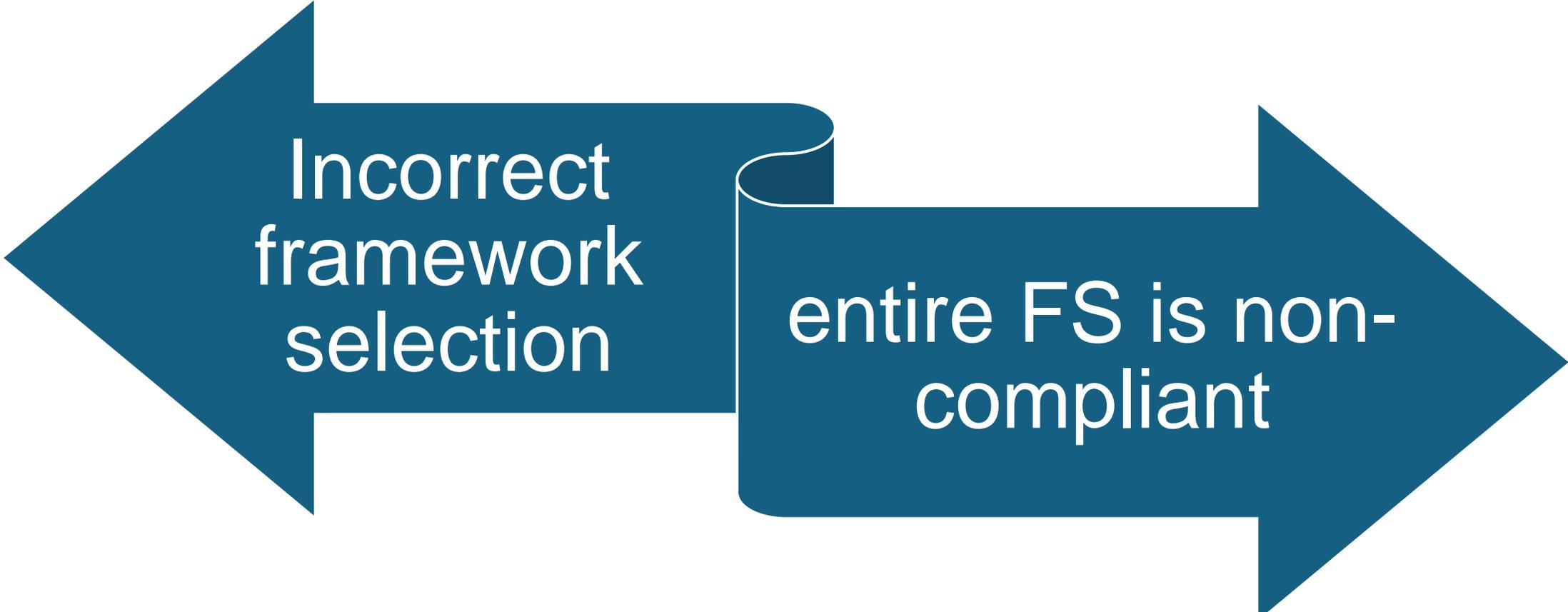
Whether AS will be applicable for such entities? What do you think?



Applicability of AS



Incorrect framework selection



Incorrect
framework
selection

entire FS is non-
compliant

Case Scenario 1

Sigma Tools Pvt Ltd qualifies as an SMC for FY 2023–24.
Management decides to:

- Not obtain an actuarial valuation for gratuity.
- Omit related party disclosures under AS 18.
- Not prepare a Cash Flow Statement.
- Skip disclosure of useful life changes for PPE.

Is the approach followed is correct?

Case scenario 2

Delta Manufacturing Pvt Ltd was a Large Company for FY 2022–23 and FY 2023–24 based on turnover and borrowings.

In FY 2024–25, its turnover and borrowings fall substantially, and it obtains an MSME (Udyam) registration.

Management concludes:

“We are now an MSME. We will apply SMC exemptions from FY 2024–25 onwards (reduced disclosures, no actuarial valuation, limited RPT disclosures, etc.).

Whether the view can be justified? What do you think?

Accounting Standard 9

Revenue Recognition

Revenue Recognition

- Revenue recorded on invoicing instead of transfer of risks.
- Retention money recognised without certainty of collection.
- LD/penalty adjustments ignored.
- Service revenue without stage-of-completion assessment.
- Bill-and-hold and advance billing misinterpreted.

Accounting Standard 2

Valuation of Inventories

Inventory valuation & NRV

-
- No documented NRV assessment.
 - Obsolete / slow-moving inventory not written down.
 - Inconsistent cost formulas across branches.
 - Abnormal loss incorrectly included in cost.
 - Overhead absorption errors.

Accounting Standard 10

Property, Plant and Equipment

PPE, Depreciation and Repairs

Capital vs revenue expenditure misclassification.

Component accounting not applied.

Major overhauls expensed instead of capitalised.

Derecognition of replaced components ignored.

CWIP held for years without review or impairment.

Accounting Standard 29

Provisions, Contingent Liabilities and Contingent Assets

Provisions and Contingencies

- Provisions created without a present obligation.
- Onerous contracts not recognized.
- Contingent liabilities not disclosed adequately.
- Statutory dues treated incorrectly as contingent.
- No evidence supporting estimates used.

Accounting Standard 15

Employee Benefits

Certain fundamental questions...

Whether Directors are employees?

Whether formal employee-employer relationship required for applicability of AS 15?

Whether provision required for obligations arising out of informal practices (constructive obligations)?

Whether this standard is applicable to all entities?

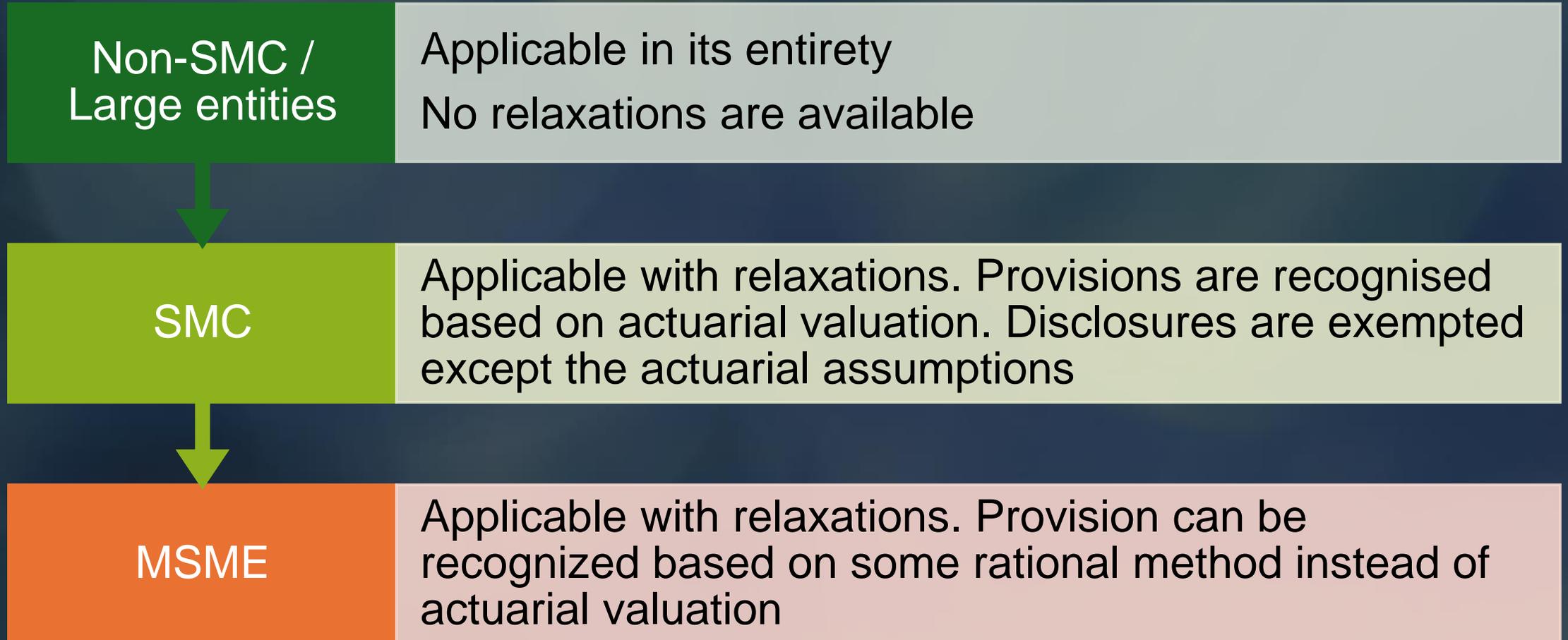
Scenario 3: Accounting policy of a company

“The Company had not provided the provision for gratuity considering the employee turnover and uncertainties regarding estimating the obligation. None of the employees had completed 5 years of service as at Balance Sheet date. Gratuity payable, if any, will be accounted as and when payments are made.”

How do you deal with the same as an auditor of non-SMC?

What will be your view if it is an SMC?

Applicability of AS 15



Let's clarify...

- What is the nature of Employer's Contribution to Provident Fund?
- What will be nature of Gratuity?



Accounting for Provident Fund

Company contributes to State Fund and no obligation for further contribution

- Defined Contribution Plan
- Contribution due for the period will be recognised as expense

Company has an obligation to make good the short-fall

- Defined benefit plan
- Accounted based on actuarial valuation under projected units credit method

Accounting for Gratuity

Defined benefit Plan

Actuarial valuation is required using projected units credit method

Net defined benefit obligation will be recognised in Balance Sheet and corresponding expense is recognised.

Scenario 4: Leave encashment

A Company has a policy for providing paid leave for the employees. It can be carried forward to subsequent years.

What will be the nature of employee benefit?

Accounting for lease encashment

If the benefit falls due and expected to be availed wholly within 12 months from reporting date

- Short-term employee benefit
- Provision will be recognised at undiscounted amount for the expected cost of settling the obligation

If the benefit falls due/expected to be availed after 12 months

- Other long-term employee benefits
- Actuarial valuation is required (similar to gratuity)

Accounting Standard 22

Accounting for Taxes on Income



Certain fundamental questions...

Whether AS 22 is applicable to non-companies?

Whether current tax assets and liabilities can be offset?

Whether deferred tax to be computed using current year tax rate or future tax rate?

Applicability of AS 22

For Companies

- Applicable to all companies in its entirety.

For other than companies

- Large entities– Applicable in its entirety
- MSMEs – Only current tax portion is applicable

Components of tax expenses

Current tax

- Tax payable/ (recoverable) on taxable profit/ (loss) for the period

Deferred tax

- Future tax consequence on the timing differences between accounting income and taxable income

Provisions on current tax

- It is the tax computed in accordance with tax laws.
- Enacted tax rates to be used.
- Current tax assets and liabilities should be offset if:
 - Legally enforceable right to offset exists and
 - Entity intends to settle it on net basis



Differences between accounting income and taxable income

Permanent Differences

- Differences originate in one period and do not reverse subsequently.
- No effect on matching concept and no deferred tax recognised

Timing Differences

- Differences originate in one period and capable of being reversed in one or more subsequent periods.
- Matching concept is affected and deferred tax to be considered.

Types of timing differences

Taxable timing differences

- It will result in more tax in future when it reverses.
- Deferred tax liability to be recognised

Deductible timing differences

- It will result in more tax in future when it reverses
- Deferred tax asset to be recognised (subject to prudence)

Certain common timing differences

Depreciation charge on PPE and Section 32 & Section 35AD

Disallowance u/s 40(a)(i)/(ia)/(ib)

Disallowance u/s 40A(9) – Contribution to funds

Disallowance u/s 40A(13) – Market to market loss/ expected loss

Disallowance u/s 43B

Allowance u/s 35D

How to compute deferred tax?

Ind AS 12: Balance Sheet Approach

Compare the account base with tax base to identify temporary difference

Tax effect on temporary difference will be the closing deferred tax liability/ (asset)

Difference between closing and opening will be the charge/credit to P&L/OCI

AS 22: Income statement approach

Compare the P&L with the tax computation and identify the timing difference

Tax effect on such timing difference (originating/reversal) will be the charge/credit to P&L

Recognition of Deferred Tax Assets

Differences other than unobserved depreciation and carried forwarded losses

- **Recognise if there is a reasonable certainty** that sufficient future taxable income will be available against which it can be utilised.

Unobserved depreciation and carried forwarded losses

- **Recognise if there is a virtual certainty supported by convincing evidence** that sufficient future taxable income will be available

Reassessment as at year-end

- At each balance sheet date, an enterprise re-assesses unrecognised deferred tax assets.
- The carrying amount of deferred tax assets should be reviewed at each balance sheet date.
- An enterprise should write-down the carrying amount of a deferred tax asset to the extent that it is no longer reasonably certain or virtually certain.



Tax rate to be used

- Uses the tax rates and tax laws that have been **enacted or substantively enacted by the balance sheet date.**
- When different tax rates apply to different levels of taxable income, average rates are used.
- Deferred tax should not be discounted to their present value.

Current tax will be the higher of tax under normal provisions & tax under MAT provisions

MAT Credit Entitlement will be recognised as an asset if there is a convincing evidence that entity will pay normal tax in future with corresponding credit to tax expense

MAT Credit Entitlement will be presented under “Loans & Advances”

Deferred tax will be computed based on taxable income under normal provisions and normal tax rates only.

Applicability of MAT

Accounting Standard 11

The Effects of Changes in Foreign Exchange Rates

Issues with respect to Forex Accounting

Monetary items not restated at closing rate.

FX differences wrongly capitalised.

Forward contract premiums not amortised.

Export/import balances not aligned with AS 11.

Unrealised gains/losses misclassified.

Accounting Standard 5

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

Issues in presentation of SOPL

Prior period error rectification and misclassifications.

Errors misclassified as changes in estimates.

Adjustments wrongly passed to reserves.

Extraordinary items used casually.

Exceptional items are not properly classified

Accounting Standard 3

Cashflow Statements

Cashflow Statement - issues

- Misclassification of operating vs investing vs financing.
- Non-cash transactions not disclosed.
- Working capital adjustments incorrect.
- Components of cash and cash equivalents are not disclosed.
- Additional disclosures like extra-ordinary items etc. are not given.

Accounting Standard 16

Borrowing Costs

Whether the interest capitalisation under AS 16 is mandatory or optional?

- If an asset meets the definition of qualifying asset, it is mandatory to capitalise the borrowing cost.
- There is no option in the standard to expense off the entire borrowing cost directly to Profit & Loss.

Whether processing charges can be included in the borrowing cost eligible for capitalisation ?

- The components of borrowing costs includes “amortisation of ancillary costs incurred in connection with the arrangement of borrowings” .
- Thus, processing charges will meet the definition of borrowing costs, and its amortization can also be capitalized if it directly attributable to the acquisition, construction or production of a qualifying asset.

Should management's intention be considered to assess the 'substantial period of time to get ready for its intended use or sale'?

- Yes. When an asset is acquired, management should assess whether, at the date of acquisition, it is 'ready for its intended use or sale'.
- Depending on how management intends to use the asset, it may be a qualifying asset under AS 16.

Are specific borrowings transferred to the general borrowings pool once the respective qualifying asset is completed?

- Yes. If specific borrowings were not repaid once the relevant qualifying asset was completed, they become general borrowings for as long as they are outstanding.

When does capitalisation cease if the construction is completed in phases and each phase can be operated separately?

- Capitalisation for one given phase ceases when this phase is ready for its intended use or sale.
- Each subsequent phase will give rise to capitalisation of borrowing costs over its own construction period.

Whether the provisions of AS 16 and ICDS IX are same?

Whether the treatment of borrowing cost have any deferred tax consequences?

- No. The definition of qualifying asset, treatment of temporary income from specific borrowings and capitalization for general borrowings have significant difference in ICDS IX.
- Due to this difference, a temporary difference may arise which warrants for a deferred tax adjustment as per AS 22.

Accounting Standard 18

Related Party Disclosures

Whether AS 18 is applicable for companies only or it is applicable to non-companies also?

- AS 18 is applicable for all entities (both companies and non-companies) and there are no exemptions for SMCs and MSMEs.
- Thus, all enterprises are required to comply with AS 18.

Certain non-compliances identified by FRRB

1. The names of the related parties as well as the transactions have been disclosed but the nature of relationship with them has not been disclosed.
2. Companies are subsidiaries of some other companies. However, the names of the holding companies have not been disclosed.
3. A wholly owned subsidiary has been formed during the year however, the name of the subsidiary has not been disclosed.
4. Disclosures made were inconsistent with the Notes to Accounts, Cash Flow Statement, Director's Report, Corporate Governance Report.

Certain non-compliances identified by FRRB

5. Transactions of similar nature along with the values thereof have been disclosed on an aggregate basis against each type of related party.
6. MD, WTD, CFO, COO or the manager have not been identified as KMP and thus the remuneration paid to them or any other transactions with them have not been disclosed.
7. corporate guarantees given for credit facilities extended to the subsidiaries for loans taken have not been disclosed.

Certain non-compliances identified by FRRB

8. While the volume of transactions with the related parties has been disclosed, the year end balances have not been disclosed.
9. It has been noted that the transactions with the controlling companies and fellow subsidiaries have been disclosed together in a single column.
10. Related parties have been described “as certified by the management”
11. List of related parties where control exists includes the name of an individual and the relationship has been stated as ‘Lessor’.



Thank you

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