Commonly found Non-compliances in Financial Statements of Banks

1. <u>Case:</u> Accounting policy on 'investments' given in the financial statements of 2019-20 of one of the leading banks, inter alia, stated as follows:

*"Investments in subsidiaries / joint ventures are categorized as held to maturity (HTM) and assessed for impairment to determine **permanent diminution**, if any, in accordance with the RBI guidelines and suitable provisions are made."*

(Emphasis supplied)

<u>Decision:</u> The Board at the time of review of the financial statement of cooperative bank decided that the nonchalant drafting of policy on valuation of investment has been done by the company by loosely interchanging the word 'other than temporary' with the word 'permanent diminution', while describing the principles adopted for creation of provision for diminution in the value of the long-term investments. It was viewed that the Accounting Standard 13 requires the creation of provision in order to recognize the decline in the value of investments which is 'other than temporary' in nature. The Board viewed two words i.e., permanent diminution' and 'other than temporary diminution' carries altogether different meaning, the former involves the situation where the diminution is of indefinite and everlasting nature, whereas the latter is more empirical and involves practical situations where decline and increase in the value of investments is common phenomenon and such decline / diminution is provided for in the books if it is not temporary in nature.

It may be noted that paragraph 32 of Accounting Standard 13, Accounting for Investments, provides as follows:

"Investments classified as long-term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognize a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually."

Accordingly, the Board viewed that the use of term 'permanent diminution' may give the impression to the readers of the financial statements that company recognizes the provision for diminution of value in the long-term investments only if such reduction is of permanent nature, which is not correct and does not conform the provisions of paragraph 32.

Accordingly, the Board decided that the adopted policy on investments is not in line with the paragraph 32 of Accounting Standard 13.

2. <u>Case:</u> It was noted from the financial statement of a bank pertaining to FY 2019-20 that while making the disclosures under paragraph 120, the information required to be disclosed under subparagraphs (a) to (m) and (o) have been made however the disclosure required under sub-paragraph (n) (i) and (ii) have not been made by the company.

Decision: It may be noted that paragraph 120(n) of Accounting Standard 15 provides as follows: ***"the amounts for the current annual period and previous four annual period of:***

- ***(i)*** ***the present value of the defined benefit obligation, the fair value of the plan assets and the surplus or deficit in the plan: and***
- ***(ii)*** ***the experience adjustments arising on:***
  - ***(A) the plan liabilities expressed either as (1) an amount or (2) a percentage of the plan liabilities at the balance sheet date, and***
  - ***(B) the plan assets expressed either as (1) and amount or (2) a percentage of the plan assets at the balance sheet date."***

Accordingly, the Board decided that the requirements of paragraph 120(n) of AS 15 have not been complied with in preparation and presentation of the financial statements.

3. <u>Case</u>: It was noted from the financial statements of 2019-20 of one of the cooperative banks that in Independent Auditor's Report an 'emphasis of matters' paragraph was given by the auditor which read as follows:

"Without qualifying our opinion, we draw your attention to:
Concerns are raised regarding continuance "Going Concern" status of the Bank. However, the Bank feels that it continues to remain a "Going Concern" in view of the following:

- *The bank is permitted to operate the accounts of customers and make permitted payments and also to recover NPA/interest on loans and advances. The amounts so recovered are invested in Government Securities. Thus, the bank is carrying out limited transactions on deposits/advances/investments.*
- *At present, the Bank has sufficient liquidity and has not defaulted in maintenance of statutory liquidity requirements like SLR and CPR. The bank has excess funds of about Rs. 65 crores.*
- *On recovery front, the Bank has recovered more than Rs. 6.40 crores during the year 2018-19 and efforts are on for recovery of other NPA accounts.*
- *The Bank is being regulated and supervised by RBI. As per RBI, the directions issued for the Bank should not be construed as cancellation of banking license by them. The bank will continue to undertake banking business with restriction till financial position improves.*
- *RBI vide letter dated XX.XX.XXX advised bank to initiate process for holding Election in the Bank as per the period under administrator appointed by RBI is expiring in XX. 20XX. As informed, the Bank has initiated the process of holding elections.*

In view of the above, the Bank has prepared the accounts on "Going Concern" basis. (Refer Note No. XX) Our opinion is not qualified in respect of this matter. "

<u>Decision</u>: The Board viewed that auditor to giving the emphasis of matter paragraph on appropriateness of going concern assumptions is not in line with SA 570. It was viewed that since the adequate disclosures on use of going concern assumptions have been made by the management in notes to the accounts and also auditor has decided to give unmodified opinion on the financial statement, therefore, instead of giving emphasis of matter, auditor should have given a separate paragraph on going concern in the audit report in line with paragraph A22 of SA 570. It may be noted that as per paragraph A22 of SA 570 provides as follows:

"A22. If adequate disclosure about the material uncertainty is made in the financial statements, the auditor shall express an unmodified opinion and the auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern" to: (Ref: Para. A28–A31, A34)

(a) Draw attention to the note in the financial statements that discloses the matters set out in paragraph 19; and
(b) State that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter."

Accordingly, in light of the above, it was viewed that although the material uncertainty existed regarding use of going concern assumptions, but since the management had made appropriate disclosures in notes and auditor has decided to give unqualified opinion, hence auditor should have given separate paragraph on 'Material Uncertainty Related to Going Concern' in independent auditor's report rather than the emphasis of matter paragraph.

Accordingly, the Board viewed those requirements of paragraph A22 of SA 570 have not been complied with by the auditor.

4. <u>Case</u>: From the financial statements of a cooperative bank, FY 2019-20, it was noted that revision of the deferred tax assets was not done on annual basis. Relevant abstract of the Balance Sheet notes on deferred tax is reproduced below:

Abstract of Balance Sheet

(Amount in Rs.)

Property and Assets	**As at 31.03.20XX**	**As at 31.03.20XX**
…………..	---	---
11) Deferred Tax asset	50,000,000	50,000,000"

"Note XX. Accounting policy on Deferred Taxes
In view of losses as per the books and as per the computation of income, there is no tax liability and hence, no provision for income tax is made in the accounts. Deferred tax arising out of timing differences between Book Profit and Taxable Profit has also not been recognized due to uncertainty about realization of deferred tax asset out of future taxable profits. "

<u>Decision</u> The Board noted from the financial statements that company had history of incurring losses. Further, disclosures made under accounting policy on deferred taxes, it had stated that no deferred taxes were not recognized due to uncertainty about realization of the deferred tax assets out of future taxable profits. The Board, further, noted from the Balance Sheet of the company that a deferred tax asset was disclosed there at Rs. 50,000,000. It was noted that the previous year's closing balance of the deferred tax assets is also Rs. 50,000,000 implying that no revision of such deferred tax assets was done by the company in line with paragraph 26 of AS 22. It may be noted that paragraph 26 of AS 22 provides as follows:

26. 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, as the case may be (see paragraphs 15 to 18), that sufficient future taxable income will be available against which deferred tax asset can be realised. Any such write-down may be reversed to the extent that it becomes reasonably certain or virtually certain, as the case may be (see paragraphs 15 to 18), that sufficient future taxable income will be available."

The Board viewed that adopted policy on deferred taxes does not talk about whether the review of deferred tax asset was done by the company at each balance sheet date. The fact that carrying value of deferred tax is the same for previous year and current year, implies that review was not done by the company at all.

Accordingly, it was viewed that the requirements of paragraph 26 of AS 22 have not been complied with in preparation and presentation of the financial statements.

5. Case: It was noted from the financial statements of one of the cooperative banks that disclosure of shares capital was not made in line with the format prescribed in Third Schedule to the Banking Regulation Act, 1949. Relevant abstract of the disclosures made on Share Capital given in Financial Statements of 2019-20 is reproduced below:

(Amount in Rs.)

Particulars	**As at March 31, 2019**	**As at March 31, 2018**
…		
Issued, Subscribed and Paid up:		
15,565,118 (15,565,118) shares of Rs. 10 each fully paid:		
Held by:		
Individuals: 82,18,768 (82,18,768)	82,187,680	82,187,680
Others: 73,46,350 (73,46,350)	73,463,500	73,463,500"

Decision: It may be noted that section 56(zl) of Banking Regulation Act, lays down the format of the Third Schedule applicable on co-operative banks which prescribe that Capital should be shown in the following format:

"CAPITAL AND LIABILITIES

Rs. P. Rs. P.

1. Capital
   (i) Authorized Capital
   ....Shares of Rs .... each ....Shares of Rs. each

   (ii) Subscribed Capital
   ....Shares of Rs .... each ....Shares of Rs each

   (iii) Amount called up On
   .... Shares at Rs........... each
   less called unpaid
   On........... Shares at Rs.......... each of

Of (iii) above, held by
(a) Individuals
(b)Co-operative institutions
(c) State Government. "

The Board noted that while disclosing the amount called up on share capital number and amount of shares allotted to 'individuals' and 'others' was disclosed. The Board viewed that such disclosure is not in line with the prescribed format which requires disclosure of shares issued to 'individuals', 'cooperative institutions' and 'state government'. It was viewed that nature of such 'others' should have been disclosed.

Accordingly, it was viewed that the format of financial statements prescribed for cooperative banks under Third Schedule have not been complied with.

6. <u>Case</u>: It was noted from the financial statements of one of the commercial banks pertaining to FY 2019-20 that disclosure of 'Other Income' was not made in line with the Schedule 14 of Third Schedule to the Banking Regulation Act, 1949. Relevant abstract of the schedule 14 of the financial statements is reproduced below:

Particulars	**Year ended 31-03-2020**	**Year ended 31-03-2019**
Profit / (Loss) of sale of investments	XXX	XXX
Profit / (Loss) of sale of land and building and other assets (net)	XXX	XXX
Profit on exchange/ derivative transactions.	XXX	XXX

<u>Decision</u>: The Board noted from the Schedule 14 of the Financial Statement that profit on sale of investments and land and building & other assets have been disclosed on net basis. It was noted that Schedule 14 on 'Other Incomes' given under Third Schedule requires separate disclosure for profit made and loss incurred on sale of investments, land & building and other assets. Disclosing on net basis indicates that losses on sales of these assets have been set of and resultant figures has been disclosed in the financial statements. Accordingly, the Board viewed that profit and loss on sales of investments, land & building and other assets should have been disclosed separately in line with the prescribed format.

Accordingly, it was viewed that the prescribed format for disclosure of other incomes in Schedule 14 given under Third Schedule to the Banking Regulation Act, 1949 have not been followed in preparation and presentation of the financial statements.