Commonly found Non-compliances in Financial Statements of Companies – Statement of Profit and Loss

INTEREST INCOME

1. **<u>Case</u>:** Interest income is not recognized on the basis of effective interest rate (EIR) method. The relevant abstract of the accounting policy on other income reads as follows:

   "Interest income from a financial asset is recognised when it is probable that the economic benefits will flow to the Company and the amount of income can be measured reliably. Interest income is accounted on accrual basis. Dividend income is accounted for when the right to receive is established."

   <u>Principle</u>: Ind AS 109: Financial Instruments

   Paragraph 5.4.1

   "Interest revenue shall be calculated by using the effective interest method (see Appendix A and paragraphs B5.4.1–B5.4.7). This shall be calculated by applying the effective interest rate to the gross carrying amount of a financial asset except for

   (a) purchased or originated credit-impaired financial assets. For those financial assets, the entity shall apply the credit adjusted effective interest rate to the amortised cost of the financial asset from initial recognition.

   (b) financial assets that are not purchased or originated credit impaired financial assets but subsequently have become credit-impaired financial assets. For those financial assets, the entity shall apply the effective interest rate to the amortised cost of the financial asset in subsequent reporting periods."

   <u>Observation:</u> The Board viewed that as per paragraph 5.4.1 of Ind AS 109 interest income is required to be measured using the effective interest rate method. However, it was noted from the accounting policy on Other Income that the interest income has not been recognised using EIR method.

   Accordingly, it was viewed that the requirements of Ind AS 109 have not been complied with in preparation and presentation of the financial statements.

GOVERNMENT GRANT

2. **<u>Case:</u>** From the Note on Capital and other commitments, it was noted that company has received exemption of custom duty under Software Technology Parks of India

scheme. The relevant abstract of note on 'Capital and Other Commitments' is reproduced below:

"Capital and Other Commitments

…

Other Commitments

The Company has export obligations under the Software Technology Parks of India (STPI) scheme. In accordance with such scheme, the Company procures capital goods without payment of duties, for which, agreements and bonds are executed by the Company in favor of the Government. In case the Company does not fulfil the export obligation, it is liable to pay, on demand an amount equal to such duties saved including interest and liquidated damages. As at March 31, 20XX, the Company has availed duty benefits. The Company expects to meet its commitment to earn requisite revenue in foreign currency as stipulated by the STPI regulations."

Principle: Ind AS 20: Accounting for Government Grants and Disclosure of Government Assistance

Paragraph 3

"Government grants are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the entity."

Paragraph 39(a)

"The following matters shall be disclosed:

(a) the accounting policy adopted for government grants, including the methods of presentation adopted in the financial statements;"

Observation: The Board viewed that the exemption of custom duty under Software Technology Parks of India scheme is a government grant and should be accounted for as per the provisions of Ind AS 20. However, the company has not disclosed the policy on accounting for Government Grant as required by paragraph 39(a) of Ind AS 20.

Similar view was taken by the ITFG, ICAI under Issue 105 given in the Compendium of ITFG Clarification Bulletins, December 2018 edition.

Accordingly, it was viewed that the requirements of Ind AS 20 have not been complied with.

CORPORATE SOCIAL RESPONSIBILITY

3. **Case:** Certain disclosures of Corporate Social Responsibility (CSR) expenses have not been made in the financial statements. The relevant abstract of 'Other Expenses' given in the financial statements read as follows:
"Other Expenses

		(Rs. in Lacs)
	Year Ended 31.03.20XX	**Year Ended 31.03.20YY**
…………….	---	---
CSR related expenses	XXX	XXX"

The amount of "Other Expenses" as reported in the Statement of Profit and Loss and in the corresponding Note of Other Expenses for the year ended 31st March 20XX and 31st March 20YY is different.

Principle: Guidance Note on Division II - Ind AS Schedule III to the Companies Act, 2013

Paragraph 11.5(b)

"The notes to accounts relating to CSR expenditure should also contain the following:

(1) Gross amount required to be spent by the company during the year.
(2) Amount spent during the year on:
   (i) Construction/acquisition of any asset,
   (ii) On purposes other than (i) above.

The above disclosure, to the extent relevant, may also be made in the notes to the cash flow statement, where applicable."

Observation: It was noted from the Note on 'Other Expenses' that the company has incurred expenses on CSR activities. However, the company has not disclosed the gross amount required to be spent during the year, amount spent on construction and otherwise in line with paragraph 11.5(b) of Guidance Note on Division II - Ind AS Schedule III to the Companies Act, 2013.

Accordingly, it was viewed that the requirements of paragraph 11.5(b) of Guidance Note on Division II - Ind AS Schedule III to the Companies Act, 2013 have not been complied with in preparation and presentation of the financial statements.

INCOME TAX

4. **<u>Case</u>:** The accounting policy of Income Tax, inter alia, states that the deferred tax assets have been recognized and carried forward only to the extent of reasonable or virtual certainty, as the case may be, that the assets will be realized in future. The relevant abstract of Accounting Policy on Income Tax reads as under:

   "Income Tax:
   1. Provision for Current Tax is made as per the provisions of the Income Tax Act, 1961.
   2. Deferred Tax resulting from "timing differences that are temporary in nature" between accounting and taxable profit is accounted for, using the tax rates and laws that have been enacted as on the Balance Sheet date. The deferred tax assets are recognized and carried forward only to the extent that there is a reasonable or virtual certainty, as the case may be, that the assets will be realized in future."

   <u>Principle:</u> Ind AS 12: Income Taxes

   Paragraph 24

   "A deferred tax asset shall be recognized for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilized, unless the deferred tax asset arises from the initial recognition of an asset or liability in a transaction that:

   (a) is not a business combination; and
   (b) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).

   However, for deductible temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, a deferred tax asset shall be recognized in accordance with paragraph 44."

   <u>Observation:</u> The Board viewed that the use of the word 'reasonable and virtual certainty' has been derived from AS 22 on "Accounting for taxes on Income" under Indian GAAP. However, financial statements are prepared by the company under Ind AS framework and paragraph 24 of Ind AS 12 uses the term 'probable' and not the terms 'reasonable or virtual certainty'.

   Accordingly, it was viewed that the adopted policy on Income Taxes is not in line with the Ind AS 12.

EARNINGS PER SHARE

5. **<u>Case</u>:** From the notes to the financial statements, it was noted that bonus shares were issued by the company during the year, but these bonus shares were not considered

for calculation of basic and diluted earnings per share of previous year. The relevant abstract of Note on Earnings per share (EPS) and Statement of Changes in Equity read with Note on Other Equity is reproduced below:

"Note 33 Earnings per Share (EPS)

Particulars	**As at 31st March, 20XX**	**As at 31st March, 20YY**
Profit after Tax (Rs. In Lacs	XXX	XXX
Weighted average number of equity shares – Basic and Diluted	XXX	XXX
Earnings Per Share (in Rs.) – Basic and Diluted	XXX	XXX

Note (i): The Board of directors in its meeting held on ……, 20XX had recommended issue of bonus shares in the ratio of one equity shares of Rs. 1 each for one existing equity share of Rs. 1 each held. The issue of bonus share was approved by the shareholders on ……, 20XX and accordingly the company allotted …... fully paid equity shares on ……, 20XX."

"Statement of Changes in Equity

Equity Share Capital

……….

B. Other Equity

(Rs. in Lacs)

Particulars	**General Reserve**	**Retained Earnings**	**Total Other Equity**
……….	---	---	---
As at 31st March, 20XX	XXX	XXX	XXX"

"Note on Other Equity

Particulars	**As at 31st March, 20XX**	**As at 31st March, 20YY**
……….	---	---
Total	XXX	XXX"

<u>Principle</u>: Ind AS 33: Earning Per Share

Paragraph 64

"If the number of ordinary or potential ordinary shares outstanding increases as a result of a capitalization, bonus issue or share split, or decreases as a result of a reverse share split, the calculation of basic and diluted earnings per share for all periods presented shall be adjusted retrospectively. If these changes occur after the reporting period but before the financial statements are approved for issue, the per share calculations for those and any prior period financial statements presented shall be based on the new number of shares. The fact that per share calculations reflect such changes in the number of shares shall be disclosed. In addition, basic and diluted earnings per share of all periods presented shall be adjusted for the effects of errors and adjustments resulting from changes in accounting policies accounted for retrospectively"

<u>Observation:</u> It was noted that the bonus shares were issued by the company during the year and the same has, although, been considered for calculation of basic and diluted earnings per share for current financial year, however, these bonus shares were not considered for calculation of basic and diluted earnings per share of previous year. It may be noted that paragraph 64 of Ind AS 33 provides that in case of issue of bonus shares, calculation of basic and diluted earnings per share for all period presented will be adjusted retrospectively.

Accordingly, it was viewed that requirements of paragraph 64 of Ind AS 33 have not been complied with in preparation and presentation of the financial statements.

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