Commonly Observed Regulatory Non Compliances – Schedule III of Companies Act, 2013 & CARO

Awareness Programme on Financial Reporting Practices – Borivali (Central) CPE Study Circle of WIRC of ICAI

By CA Amit Purohit

Coverage

- Presentation based on FRRB observations on review of Financial statements of select entities

  - Observations on presentation and disclosures of Financial statements (Revised Schedule VI- now Schedule III)

  - Observations on reporting practices of Audit reports

  - CARO –commonly observed non-compliances

Schedule –III (Background)

- Schedule III read with section 129 of the Companies Act, 2013 prescribes the format of the financial statements (i.e. Balance sheet and Statement of Profit and Loss) and general instructions for preparation of the same. Format of Cash flow statement is governed by AS-3.

- Schedule III of Companies Act, 2013 replaces Revised Schedule VI (with additional requirements for preparation of CFS).

- Recently, Schedule III amended to also prescribe format for Ind-AS compliant financial statements.

Objectives of Schedule III

- To provide a readable, useful, transparent and user friendly form of Financial Statements.

- To set out minimum disclosure requirements to ensure true and fair presentation of the Financial Position and Financial Performance of the Company.

- To optimize disclosure requirements in Financial Statements.

Objectives of Schedule III

- To remove disclosure requirements meant for statistical purposes only.

- To attain compatibility and convergence with the International Accounting Standards & Practices.

Overview

- If compliance with the requirements of the Act including Accounting Standards requires a change in the treatment or disclosure in the financial statements, then the changes as per the requirements of the Act/Accounting Standards shall be made and the requirements of Schedule III shall stand modified accordingly.

- Information relating to each item on the face of the Balance Sheet and the Statement of Profit & Loss to be disclosed in the notes with a cross reference.

Schedule III and AS

- Disclosure Requirements specified in Schedule III are **in addition to** and not in substitution of the Disclosure Requirements specified in Accounting Standards prescribed under the Companies Act.

- Additional Disclosures specified in the Accounting Standards to be made in the **Notes to Accounts** or by way of **Additional Statement**, unless required to be disclosed on the face of the Financial Statements.

- All other disclosures as required by the Companies Act to be made in the **Notes to Accounts** in addition to requirements set out in Schedule III.

Extent of disclosure requirements

- Schedule III represents **Minimum** Disclosure requirements.
- There is a need for balancing between – (a) Providing Details, and (b) Obscuring Information.
- Use of Sub–Totals may be adopted wherever relevant and meaningful.
- Industry Specific Disclosures should be given wherever applicable.
- Concept of Broad Heads under Statement of Profit and Loss based on Materiality & True and Fair criteria.

Extent of disclosure requirements

- Disclosure of EBITDA is also done by Companies, even if not specifically required under Schedule III.

- Rounding Off Principles are optional. A Company can continue to disclose full figures also.

Consolidated financial statements

- Requirement of Schedule III applies to Consolidated financial statements too. Earlier, consolidated financial statements were required only for listed companies.
- Additional information by way of parent / subsidiaries share in the net assets and profit or loss etc. are required to be given.
- Consolidated financial statements to be audited, approved and adopted in similar way as standalone financial statements.

Non-Compliance/Inadequate Disclosures	Technical Requirement as per Schedule III
<u>Operating Cycle</u>	
1.Non disclosure of the Operating Cycle	Operating Cycle should be disclosed especially, if it is beyond 12 months. Such disclosure would be of help to the users of FS where determination of operating cycle involves significant judgment. (Q34 of FAQs)
<u>Share Capital</u>	
1. Company having only one class of shares – Equity. It did not disclose rights, preferences and restrictions, if any w.r.t. such shares.	As per Para 6A(e), a Company has to disclose the rights, preferences and restrictions attaching to each class of shares, even if it has only class of shares.
2. Reconciliation of each class of shares outstanding was not disclosed	Para 6A(d) read with GN Para 8.1.1.9 mandates disclosure for each class of shares with opening number of shares outstanding, shares issued, bought back, other movements, etc and closing number of shares outstanding.

Non-Compliance/Inadequate Disclosures	**Technical Requirement as per Schedule III**
3. Disclosure made of shareholders holding more than 5% shares, from where it was noticed that there was a company holding more than 51% shares. However, disclosures regarding holding company not made.	As per Para 6A(f), company has to disclose in each class of shares, the shareholding of its holding company, or by subsidiaries or associates of the holding company or the holding company in aggregate.
4. Unpaid Calls not reflected as reduction from Share Capital but shown as receivable without adequate disclosure.	Para 6A(b) requires details of shares subscribed and fully paid up as well as shares subscribed and not fully paid up to be shown separately. Further, Para 6A(k) requires disclosure of calls unpaid, with a separate disclosure for the aggregate value of calls unpaid by directors and officers of the company. Hence gross amount of Share Capital should be disclosed first and then calls unpaid should be reflected as a deduction.(Refer Q45 of FAQs)

Non-Compliance/Inadequate Disclosures	**Technical Requirement as per Schedule III**
5.Share Application Money reflected as part of Share Capital	Share Application Money pending allotment is a separate line item after Shareholders' Funds and before Non-Current Liabilities.
<u>Reserves & Surplus</u>	
1.For each item only the final amount at the end were reflected, without the movements during the year.	As per Para 6B(i) additions and deductions since last balance sheet has to be shown under each of the specified heads.
2. Appropriations from Profit for the year were reflected on the face of the Statement of Profit and Loss.	This was the practice as per Old Schedule VI. However, as per Para 6B(i)(h), the appropriations and allocations such as dividend, transfer to/from reserves has to be through Reserves and Surplus after transfer of Surplus from Statement of Profit and Loss.

Non-Compliance/Inadequate Disclosures	**Technical Requirement as per Schedule III**
3.Debit Balance of Statement of Profit and Loss was reflected on Assets side of the Balance Sheet.	As per Para 6B(iii), debit balance of Statement of Profit & Loss shall be shown as a negative figure under the head surplus. Even, after adjusting the balances of other Reserves the final balance is negative, the same will continue to be reflected as a negative figure in Reserves and Surplus.
<u>Long Term and Short Term Borrowings</u>	
1. Secured Borrowings includes loan availed by creating charge on the property of a director and his personal security.	As per GN Para 8.3.1.13 and Q.14 of FAQs, if the borrowing is on security of promoters, shareholders or other third party, there has to be a disclosure of such security offered for borrowing. However, such security does not result in the classification of such borrowing as secured.

Non-Compliance/Inadequate Disclosures	Technical Requirement as per Schedule III
2. Current Maturities of Long Term Borrowings were reflected as Short Term Borrowings.	As per Para 6G(a) current maturities of Long Term Debts are to be disclosed under the head "Other Current Liabilities". GN Para 8.3.1.10 also reiterates that the current maturities of all long term borrowings will not be disclosed under "Short Term Borrowings".
3.Bonds/Debentures were disclosed with the type of bonds/debentures and rate of interest only.	As per Para 6C(iv) disclosure for bonds/debentures should also include particulars of redemption/conversion and shall be stated in descending order of maturity or conversion date.
4. Short Term Borrowings included Working Capital Limits, however separate disclosure was not made.	As per Para 6F(i)(a), Loans Repayable on Demand have to be disclosed separately with further break up (a) From Banks and (b) From Others Parties.

Non-Compliance/Inadequate Disclosures	Technical Requirement as per Schedule III
5. Classification of Loan as a non-current liability in the previous year, which on becoming a current liability during the current financial year, the company re-classifies the loan as current for previous year also.	Classification of current/non-current is as of a particular date i.e balance sheet date. If there is a change in classification during subsequent year it is so for that year. It would not change the position as of previous year and hence previous year classification should remain unchanged. (Refer Q.15 of FAQs).
6. A Convertible Debt instrument maturing after 2 years, where the conversion option for issuance of equity is exercisable by the holder at any time classified as "Short Term Borrowing".	The terms of settlement of a liability do not affect its classification. In the instant case the maturity for cash settlement was after 2 years and accordingly the same should have been classified as "Non-Current". (Refer GN Para 7.5.1).

Non-Compliance/Inadequate Disclosures	Technical Requirement as per Schedule III
Trade Payables	
1.Trade Payables includes dues payable in respect of statutory obligations like PF, dues towards purchase of fixed assets and other contractual obligations.	Any Payable which is in respect of amount due towards goods purchased or services received in the ordinary course of business, shall be classified as Trade Payable. Other payables as in this case cannot form part of Trade Payables, but would be classified as "Other Current/Non-Current Liabilities".(Refer Para 8.4.1 of GN).
Provisions (Long Term/Short Term)	
1.Valuation of Gratuity/Leave Encashment done by Actuary provided current and non-current portion for both, but Gratuity classified as Long Term Provision and Leave Encashment classified as Short Term Provision	If there is a classification provided by Actuary on the basis of retirement and attrition rate, then the current portion of both should be treated as Short Term Provision and non-current portion of both should be treated as Long Term Provision. (Refer Q.30 of FAQs).

Non-Compliance/Inadequate Disclosures	Technical Requirement as per Schedule III
2. Provision for Tax (net of advance tax) for the year disclosed as Long Term Provision.	Current Year's Provision for Tax should generally be classified as Short Term Provision as the same would be payable within 12 months from the Balance Sheet date. (Refer Q.31 of FAQs).
<u>Fixed Assets</u>	
1. A company having Tangible and Intangible assets did not categorize the same accordingly.	As per Para 6 I and J, there is a requirement to classify assets into Tangible and Intangible Assets. Further, as in Tangible Assets where the work in under progress is disclosed separately as Capital Work in Progress, for Intangible Assets also which are under development, there is a requirement to disclose separately as Intangible Assets under Development.

Non-Compliance/Inadequate Disclosures	Technical Requirement as per Schedule III
2. Advance given for Capital Asset where the work is under progress included in Capital Work in Progress.	Any advance for purchase/creation of fixed assets has to be classified as Long Term Loans and Advances. (Refer Para 6 L(i)(a) Capital Advances).
3. Assets identified as “Fixed Assets Held for Sale” were included in Fixed Assets Schedule.	Such assets should be classified as Current Assets, since the intent to sell such assets is established by the Company. (Refer Q.17 of FAQs).
4. Tangible Assets included owned assets as well as leased assets, however no such break up provided in the Tangible Assets schedule.	As per Para 6 I (ii) under classification of Tangible Assets into various categories, assets under lease have to be separately specified for each such category of asset.
Investments	
1. Investment in Associate and Joint Venture was not disclosed, though such disclosure made in Related Party Transactions.	There is a requirement as per Para 6 K(i) to separately categorize investments in subsidiaries, associates, joint ventures with extent of investment in such entities.

Non-Compliance/Inadequate Disclosures	Technical Requirement as per Schedule III
2. Total Long Term Investment was disclosed and Total Provision for all the Investments together was reflected.	As per AS-13, value of each Long Term Investment has to be carried at cost less Provision for other than temporary diminution in value thereof. However, aggregate amount of provision made in respect of all Non-Current Investment should also be disclosed separately as per the requirement of Schedule III Para 6K(iii). (Refer GN Para 8.7.2.3).

Non-Compliance/Inadequate Disclosures	Technical Requirement as per Schedule III
3. Investment in Partnership Firms included investment in LLPs.	LLP is a body corporate and not a partnership firm. Hence disclosures of investment in Partnership Firms would not include investment in LLPs. Such investments should be disclosed separately under "Other Investments". Other disclosures required for Partnership Firms also need not be made for LLPs.
<u>Inventories</u>	
1. Trading Stock of the Company into manufacturing and trading was included in Finished Goods Stock.	As per Para 6O(i)(d) there is a requirement to disclose separately Stock-in-Trade (in respect of goods acquired for trading).
2. Goods in Transit including towards Raw Materials, Stock-in-trade and Stores and Spares was disclosed together as such.	As per Para 6O(i)(ii) there is a requirement that Good-in-transit for each category of inventory should be disclosed under the relevant sub-head of inventories.

Non-Compliance/Inadequate Disclosures	**Technical Requirement as per Schedule III**
<u>Trade Receivables</u>	
1. Trade Receivables outstanding for more than six months were considered from the date of invoice.	As per Para 6P(i) Trade Receivables outstanding for a period exceeding six months is to be considered from the date they are due for payment.
2. Trade Receivables included receivables due from sale of Fixed Assets and Investments.	A Trade Receivable is only in respect of the amount due on account of goods sold or services rendered in the ordinary course of business. Amount due on account of other contractual obligations cannot form part of Trade Receivables but are to be classified as "Others" (Refer Para 8.7.4 of GN).

Non-Compliance/Inadequate Disclosures	**Technical Requirement as per Schedule III**
<u>Cash and Cash Equivalents</u>	
1. Fixed Deposits having maturity beyond 12 months disclosed under this head.	Fixed Deposits with more than 12 months maturity have to be disclosed as "Other Bank Balances" and the non-current portion of such deposits should be classified under the head "Other Non-Current Assets". (Refer Para 8.8.4 of GN).
2. Balance in Unpaid Dividend Account included in Balances with Banks while preparing Cash Flow Statement.	As per Para 6Q(ii) earmarked balances with banks like unpaid dividend shall be separately stated and this should not form part of the Cash Flow of the Company.
<u>Loans and Advances (Long Term/Short Term)</u>	
1. Provision for Bad and Doubtful Advances were disclosed combined for all types of Loans and Advances.	As per Para Para 6L(iii)(b) and 6R(iii) allowance for bad and doubtful loans and advances shall be disclosed under the relevant heads separately.

Non-Compliance/Inadequate Disclosures	**Technical Requirement as per Schedule III**
2. Loans and Advances to Related Parties was not disclosed.	As per Para 6L(i)(c) and 6R(i)(a) Loans and Advances to Related parties are to be disclosed separately with details thereof. The term "details" should be interpreted to understand the disclosure requirements as per AS-18 Related Party Disclosure.
3. Advance Tax (Net of Provision) disclosed as Current Asset.	As per Para 8.7.3 of GN and Q31 of FAQs, current year's advance tax (net of provision) as well as earlier year's advance tax shall generally be classified as non-current. However, advance tax against which refund orders have been passed will only be treated as current.

Non-Compliance/Inadequate Disclosures	Technical Requirement as per Schedule III
<u>Commitments</u>	
1. Company was having ongoing expansion; however there was no disclosure of Capital Commitments.	As per Para 8.8.7.4 of GN, future liability for capital expenditure in respect of which contract have been made should be disclosed. The Capital Commitments have to be disclosed net of advances, if any which would have been disclosed as Capital Advances.
<u>Revenue from Operations/Other Income</u>	
1. Company had revenue from sale of products as well as services which were disclosed combined.	As per Part II Para 2A, Revenue from Operations shall have break up of Sale of Products; Sale of Services and Other Operating Revenues.
2. Profit from Sale of Scrap arising from manufacturing operations was disclosed as Other Income.	Such income should be treated as Other Operating Revenue, since the same arises on account of the company's main operating activity. (Refer Para 9.1.8 of GN).

Non-Compliance/Inadequate Disclosures	**Technical Requirement as per Schedule III**
3. Profit on Sale of Fixed Assets and Net Foreign Exchange Gain was classified as Other Operating Revenue.	Sale of fixed assets is not an operating activity and hence profit from such sale should be classified as Other Income. Similarly, gain from Foreign Exchange, is purely earned on account of fluctuation in exchange rates and not on account of sale of products/services. Hence the same should be classified as Other Income. (Refer Para 9.1.8 and 9.1.9 of GN).
4. Details of Other Operating Revenue were not disclosed.	As per Para 2A there is a requirement to disclose separately.
<u>Expenses</u>	
1. Details of Raw Materials and Goods Traded by the Company were not disclosed under broad heads.	As per Para 5A (ii)(a) there is a requirement to disclose Raw Materials and Goods Purchased under the broad heads.

Non-Compliance/Inadequate Disclosures	**Technical Requirement as per Schedule III**
2. Expenses classification provided as per the functions carried out in the company.	The format laid down in Schedule III for presentation of items of income and expense indicates that the expenses should be aggregated based on their nature and hence functional classification of expenses is prohibited. (Refer Para 9 of GN).
3. Payment to Auditors was disclosed as a single line item.	As per Para 5A(j) there is a requirement to give break up of Payment to Auditors as (a) Auditor; (b) for taxation matters; (c) for company law matters; (d) for management services; (e) for other services and (f) for reimbursement of expenses.

Non-Compliance/Inadequate Disclosures	Technical Requirement as per Schedule III
<u>**Notes to Financial Statements**</u>	
1. MSMED disclosure was not made.	Disclosures as mandated by other acts or statutes will have to be made in the FS. This applies to other disclosure requirements as per MSMED Act, 2006, Clause 32 of Listing Agreement, etc. (Refer Para 6.8 and 6.9 of GN). **[Schedule III amended to include disclosures required under MSMED Act]**
2. Proposed dividend was disclosed in Notes and there was no provision made.	As per AS-4 there is a requirement to provide for the dividend for the period covered by the FS. Though Schedule III requires dividend to be disclosed by way of a note, the AS would override Schedule III requirements and hence provision is required. (Refer Para 8.8.7.7 of GN). **[newly notified AS-4 does not require provision]**
3. Expenditure in Foreign Currency disclosed on payment basis.	Such disclosure is required to be made on accrual basis since all the items in Statement of Profit and Loss are stated on accrual basis. (Refer Para 11.2.5 of GN).

Cash Flow Statement (observations)

- Inconsistencies in disclosures:

- Certain disclosures made in the Financial statements such as “amount written off / back, unrealised foreign exchange gains /losses but not reflected in Cash Flow Statement

- Cash and Cash Bank balance as per note to the financial statements not matching with Cash flow statement

Audit Report

- **Observations / Suggestions:**
- Reference to Cash flow statement in the introductory paragraph but opinion para does not mention about the same (true and fair not expressed for Cash flow Statement)
- Membership number not mentioned in the audit report / Annexure to the Auditors' report

Audit Report

- The Auditor has signed the audit report before the financial statements have been approved and signed by the Board
- Audit report not addressed to any one
- Opinion para does not indicate the financial reporting framework used in the preparation of the financial statements

Audit Report

- No reference was given to the significant accounting policies and other explanatory information in the introductory paragraph

- Auditors' responsibility paragraph did not specify about the:
  - Compliance with the ethical requirements;
  - Reasonable assurance obtained as to whether the financial statements are free from material misstatement

CARO observations

- Certain clauses not applicable –however, not applicability of such clauses not mentioned by the Auditors in the audit report.

- *"The Management has conducted physical verification of fixed assets during the year and we are informed that discrepancies noticed were not material"*
  - Specify the reasonableness of physical verification with respect to the size of the company and nature of its fixed assets

CARO observations

- "….we are informed that….." phrase creates an impression that the auditor has completely relied upon the management's representation
- Auditors' duty is to express his opinion and not merely state the information provided by the Management

CARO observations

- *“Inventories have been physically verified by the management during the year and at the year end. In our opinion, the frequency of such verification is reasonable and no material discrepancies were noticed on such physical verification”*

- No reference to “Stocks lying with the third parties” and “Stocks in Transit”

CARO observations

- *"The company is regular in depositing undisputed statutory dues including Provident fund, Investor education and protection fund, employee 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."*
- In case of the disputed statutory dues, the amount deposited with the statutory authorities are not stated

CARO observations

- *"In our opinion and according to the information and explanations given to us, the company has not defaulted in repayment of dues to a financial institution or banks."*

  - Specify whether there were any such defaults with respect to repayments to Government and debenture holders as well

CARO Observations

- *"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 audit~~ during the year."*

- *"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 the financial statements to be materially misstated."*

- Using the words "materially misstated " could be interpreted that only frauds that misstates the financial statements will have to be reported
- In case of fraud, nature and amount involved should be indicated

Expenditure on CSR

- Check the applicability of CSR under Section 135 of the Companies Act, 2013

- Disclose separately expenditure on CSR as a note to the Statement of Profit and Loss (as required under Schedule III)

- Refer Guidance Note on CSR issued by ICAI

Thank You