

Commonly Observed Noncompliances in Audit Report and Financial Statements

About Us

- Rajput Jain & Associates is a Chartered Accountants firm, with it's headquarter situated at New Delhi (the capital of India). The firm has been set up by a group of young, enthusiastic, highly skilled and motivated professionals who have taken experience from top consulting firms and are extensively experienced in their chosen fields has providing a wide array of Accounting, Auditing, Taxation, Assurance and Business advisory services to various clients and their stakeholders, focus at providing tailor made solutions to challenging problems of our clients, and perform with high quality and timely service.
- Rajput jain & Associates, a professional firm, offers its clients a full range of services, To serve better and to bring bucket of services under one roof, the firm has merged with it various Chartered Accountancy firms pioneer in diversified fields
- Our main office is located at Delhi. Incidentally, Delhi is the Capital of India. Our other offices are in Mankapur & Moradabad (U.P.). We have associates all over India in big cities. All our offices are well equipped with latest technological support with updated reference materials. We have a large team of professionals other than our Core Team members to meet the requirements of our prospective clients including the existing ones. However, considering our commitment towards high quality services to our clients, our team keeps on growing with more and more associates having strong professional background with good exposure in the related areas of responsibility. Further to meet the growing demands of the fiercely competitive market we are constantly looking forward for team of associates comprising of highly skilled professionals to cater the needs ever increasing clientele.

Certain Issues observed or opined by ICAI

Issue 1: Inventory

While preparing its financial statements and while framing its accounting policies, Company "X", has used te following words:

'Inventories are valued using weighted average cost method or specific identification method as applicable'.

Whether the accounting policy has been disclosed properly.

- Covid Impact:
- The goods were in transit from Chennai to Delhi
- On 25th March the truck carrying goods was not allowed entry in Delhi and hence the stock was not unladen at the Company"s premises
- However the carrier preserved and handled the goods and hence raised an additional invoice on the company for Rs. x due to this contingency
- Whether Rs. x will be considered as a part of inventory cost??

Issue 2: Revenue Recognition

An entity has stated in its financial statement that revenue has been recognized in accordance with AS 9. Whether the disclosure is in accordance with AS.

Issue 3: Revaluation of Inventory

There is no provision is given under AS 2, "Valuation of Inventories" to revalue cost of items of inventory. As well, as per AS 2, inventories should be valued at the lower of cost and net realisable value. Therefore, in respect of both aspects inventory valuation policy followed by X is not correct.

Whether, inventory valuation policy of X is correct or not?

Issue 4: Cash Flow Statement

In the cash flow statement an entity has categorised its cash flows during a particular period into four categories, which are, Cash flow from Operating Activities, Cash flow From Investing Activities, Cash Flow from Financing Activities and Cash flow from Other Activities.

Whether the entity has categorised its cash flows correctly as per AS 3, Cash Flow Statements?

Issue 5: Interest u/s 234B and 234C

Short payment of advance tax installments invites levy of interest under sections 234B and 234C of the Income Tax Act. The company has following questions in regard to the classification of interest levied u/s 234B and 234C of the Income Tax Act:

Should the company classify interest u/s 234B and 234C as tax expense in the financial statements

Is such interest an 'extraordinary item' in accordance with AS 5

- RST Limited
- Holding Co. of RST Limited DEF Limited
- During the year 2019-2020 not even a single transaction has taken place between DEF and RST
- Question: Whether any disclosure under AS 18 is required
- Answer: AS 18 if RP are related due to control then even if no transactions are there – describe the relation only

- RST Limited
- Covid disruptions WFH was ordered
- Mr. R is one of the director (finance) working from home
- He was reimbursed out of pocket expenses incurred due to WFH set up
- Whether such reimbursement is related party transaction?
- Answer: Yes, it requires disclosure

Issue 6: Leasehold and Freehold Properties

The company following its past practices has shown leasehold and freehold buildings under the sub-head 'Buildings' under head 'Fixed assets'. The company has not sub-classified 'buildings' into 'freehold' and 'leasehold'.

Whether there is any statutory requirement as per the Companies Act, 2013 to show buildings as leasehold and freehold separately

- RST Limited
- 1st April, 2019 Equity Shares 10,000 shares
- 1st Oct, 2019 fresh issue 1,000 shares (additionally issued)
- 31st March, 2020 outstanding equity shares 11,000 shares
- PAT = Rs. 1,10,000
- BEPS = 1,10,000/ 11,000 = is it correct? = no
- Weighted Avg. Number of Equity Shares = [(10,000 (x) 12/12) + (1,000 (x) 6/12)] = "x" number of shares
- BEPS = 1,10,000/ "x" = this is correct position as per AS 20/ Ind AS 33

- Covid
- Real Estate Developer
- Revenue Recognition POCM
- POCM = Cost incurred till date/ Total Estimated cost (x)
 100
- Cost incurred till date = it also includes idle plant cost, labour retention cost and like due to lockdown
- Whether such costs will be considered for POCM computation

Certain Matters to be looked into by the Auditors

Certain Matters

- Auditor has mentioned his membership number "F" is prefixed to Auditor"s Report;
- Opening paragraphs of the Auditors Report states to have "examined the attached Balance Sheet....";
- Report was not addressed to anyone;
- Membership Number of auditor was only mentioned in Audit Report – what about CARO, Balance Sheet, Statement of Profit and Loss

Certain Matters under CARO

- None of the fixed assets have been revalued during the year;
- In our opinion and according to the information and explanations given to us, the Company has not defaulted in repayment of dues to financial institutions or banks;
- "The management has conducted physical verification of the fixed assets during the year and we are informed that discrepancies noticed were not material";
- "Programme of physical verification is reasonable, though all the assets not verified. Management is in process of identifying discrepancies, if any, on such verification."
- "The company has maintained proper records of inventory. No material discrepancies were noticed on physical verification of inventory except as recorded by excise department as per note....";

- CARO Para 3(i) reporting about Fixed Assets
- Schedule III Prior to amendment Balance Sheet item heading – Fixed Assets
 - after Amendment new heading Property, Plant and Equipment
- Question: How to reconcile CARO reporting with Schedule III presentation – specially when Fixed Assets includes Tangible as well as Intangible assets
- Suggestion: we report that fixed assets comprising PPE and intangible assets

Certain Matters under CARO

- "(a) The parties to whom loans have been given by the company are repaying the principal amounts as stipulated and interest thereon wherever applicable;
 - (d) In case of overdue amounts exceeding Rs.1 Lakh reasonable steps have been taken by the company for recovery of principal amount and interest thereon and necessary provisions have been made wherever such amounts appear to be doubtful of recovery";
- "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 attached in the Form 3CD attached."

- RST Limited
- Gratuity is payable under Payment of Gratuity Act and Bonus is payable under Payment of Bonus Act
- The company has delayed in making such payments
- Question: Whether such delay in payments of gratuity and bonus is reportable under Para 3(vii) of CARO
- Answer: diff is there between statutory dues and statutory obligations/ liabilities
- Statutory dues = payable to Govt.
- Statutory Obligations (like in this ques) = payable to others like employees here

Caution:

 IEPF deposit delays are not reportable under CARO. They are reportable as per Rule 11 of Audit Rules on the face of audit report

Certain Matters under CARO

- "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 our audit";
- Physical verification of the fixed assets is covered under a scheme of verification over a period of three years. No serious discrepancy was noticed on such verification during the period."

- Last year = CARO was applicable
- Current (Next) year = CARO is not applicable but still it was reported by the auditor
- Any implications ??
- ABC (P) Limited
 - Last year (17-18) = PSC = 40 lakhs and T.O. = 2.50 cr. = CARO was reported here
 - Current year (18-19) = PSC = 40 lakhs and T.O. 1.90 cr. = CARO was reported here
 - Next year (19-20) it is small company = CARO was reported here

- Section 2(85)
- Small company is a private company which fulfils BOTH the following conditions:
 - Paid up share capital ≤ Rs. 50 lakhs; AND
 - ■Turnover as per last P & L ≤ Rs. 2 crores

Note: CARO is N.A. on small company

- Last year = CARO was applicable
- Current (Next) year = CARO is not applicable but still it was reported by the auditor
- Any implications Yes
 - CA Act = disclosure of client's info. without legal requirements professional misconduct
 - Sec 147 of Co. Act if section 143 is breached then penalties u/s
 147 can be levied = CARO u/s 143(11)
- ABC (P) Limited
 - Last year (17-18) = PSC = 40 lakhs and T.O. = 2.50 cr.
 - Current year (18-19) = PSC = 40 lakhs and T.O. 1.90 cr. = small company for 19-20
 - Next year (19-20) it is small company = CARO was reported here

Books of account, etc., to be kept by company [Section 128]

- The books of account and other relevant books and papers shall be retained completely in the format in which they were originally generated, sent or received, or in a format which shall present accurately the information generated, sent or received and the information contained in the electronic records shall remain complete and unaltered Rule 3(2) of Companies (Accounts) Rules, 2014.
- Question: Does this mean that books maintained on software which allow alteration or back date entry are not as per law e.g Tally, Busy etc.

- Section 143(3)(b) and (h) report whether books of accounts have been kept properly or not – Section 128 r/w Rule 3
- Section 143(3)(i) reporting about ICOFR IT controls

CARO Points – Miscellaneous aspects due to Covid circumstances

- Para 3(i) and (ii) reporting about physical verification of Fixed Assets and Inventories at reasonable intervals – consider the impact (if any) w.r.t. lockdown restrictions
- Para 3(iii) section 189 parties reasonable steps taken to recover overdue amounts > 90 days – consider the terms of agreement/ extension granted, if any, etc.
- Para 3(vii) reporting about statutory dues consider the extension of due dates
- Para 3(viii) reporting for default in repayment of financial dues – consider the RBI announcements
- Para 3(xiii) related party WFH reimbursements (if any)

- RST Limited
- Lockdown restrictions inventories and fixed assets were:
 - Not physically verified by the company
 - Physically verified by local staff of the company
 - Physically verified by local CA engaged by the company
 - Physically verified by local CA engaged by the auditor himself
- Question: how to report the same in CARO and main face of the audit report

CARO

- It is not requiring to report whether physical verification was carried or not on Balance Sheet date
- Requirement whether physical verification was made at reasonable intervals or not
- Say if reasonable interval is end of quarter 30th
 June, 30th Sep and 31st Dec done
- But on 31st March not done

Face of the audit report

- Lockdown restrictions inventories and fixed assets were:
 - Not physically verified by the company if material report qualification + ICOFR (if applicable)
 - Physically verified by local staff of the company SA 501 says that physical verification is prime responsibility of Management – you have to check how far local staff could be relied upon – take proper MRL/ Confirmations
 - Physically verified by local CA engaged by the company
 - can give confirmations SA 600
 - Physically verified by local CA engaged by the auditor himself – can give confirmations – SA 600

Face of audit report

- SA 706
- Other Matter Paragraph
 - The physical verification was done by local staff/ local CA/ my CA and our opinion is not modified on this matter
 - The physical verification was not carried <u>AT ALL</u> due to lockdown and this inventory is not forming a material part of purchases made from 20th March to 31st March. We further report that the company has adequate cut off procedures

Documentation (SA 230) and Audit Evidence (SA 500 series)

Documentation (SA 230)

- Working Papers help in planning the audit, supervising the audit and proving that the audit was actually carried out;
- Audit files/ documentation/ working papers are the records comprising of:
 audit procedures applied

 - audit evidence obtained
 - audit conclusions achieved, during the course of audit examination
- Working Papers" property of the auditors Chantrey Martin & Co. case

Features of SQC 1 vis-à-vis SA 230

- Assembly of Audit File to be within 60 days after the date of Auditor"s Report;
- Documentation to be preserved for 7 years.

Question 1

- Which of the following need not be documented by the auditor:
 - a) Personal dispute between MD and Accountant having no impact on F.S
 - b) Contravention of income tax provisions
 - c) Contravention of AS
 - d) Completion memoranda

 Mr. A is the statutory auditor of XYZ Limited for the financial year 2018-2019. He signed the audit report on 31st August 2019. During the course of the audit examination, his article assistants and audit staff prepared working papers for various audit observations. These working papers were in loose leaflet form and were put by him into a file on 31st December, 2019.

 Mr. X is the statutory auditor of PQR Limited for past five years. He resigned from the engagement and in his place Mr. Y was appointed as the statutory auditor. The management of PQR Limited is insisting Mr. X to furnish the copies of his working papers for all the five years.

 The auditee client has provided Rs. 2 lakhs as provision for bad and doubtful debts in the books of account while the auditor is challenging this provision and opines that it should be Rs. 5 lakhs. After much deliberations and considerations both auditor and auditee concluded at a provision of Rs. 4 lakhs. The auditor did not document these deliberations and considerations as he is of the view that once he is satisfied there is no need keep any such record in his file.

Auditor's Duty for Electronic Records

- The nature and timing of the audit procedures to be used may be affected by the fact that some of the accounting data and other information may be available only in electronic form or only at certain points or periods in time;
- For example, source documents, such as purchase orders and invoices, may exist only in electronic form when an entity uses electronic commerce, or may be discarded after scanning when an entity uses image processing systems to facilitate storage and reference;
- Certain electronic information may not be retrievable after a specified period of time, for example, if files are changed and if backup files do not exist.
- Accordingly, the auditor may find it necessary as a result of an entity's data retention policies to request retention of some information for the auditor's review or to perform audit procedures at a time when the information is available.

External Confirmation – electronic means

- Responses received electronically, for example by facsimile or electronic mail, involve risks as to reliability because proof of origin and authority of the respondent may be difficult to establish, and alterations may be difficult to detect;
- A process used by the auditor and the respondent that creates a secure environment for responses received electronically may mitigate these risks;
- If the auditor is satisfied that such a process is secure and properly controlled, the reliability of the related responses is enhanced;
- An electronic confirmation process might incorporate various techniques for validating the identity of a sender of information in electronic form, for example, through the use of encryption, electronic digital signatures, and procedures to verify website authenticity.
- When a confirming party responds by electronic mail, the auditor may telephone the confirming party to determine whether the confirming party did, in fact, send the response.

Communicating Key Audit Matters in the Independent Auditor's Report [SA 701]

- RST Limited
- Board of Directors = 12 directors = as per SA 260 ~
 Management
- Audit Committee = Out of above 12 3 directors + 2 independent director is there in such committee = SA 260 ~ Those Charged with Governance (TCWG)
- Point: Don"t you think that discussing draft audit report and findings made by the auditor before issuing final audit report will achieve purpose of audit in right spirit
- SA 260 communicate certain matters with TCWG
- Certain matters not all the matters are significant some are immaterial while some are material but confidential

Key audit matters

- Those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period;
- Key audit matters are selected from matters communicated with those charged with governance.

- Step 1: communicate as per SA 260 with TCWG
- Step 2: select significant (key) matters out of Step 1
- Step 3: Report step 2 matters in Audit Report below a separate heading "Key Audit Matters" ~ along-with reasons

Notes:

- SA 701 is applicable only to listed companies
- If company is not having Audit Committee then BOD is Management as well as TCWG

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the Standalone Ind AS financial statements for the financial year ended March 31, 2019. These matters were addressed in the context of our audit of the Standalone Ind AS financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have determined the matters described below to be the key audit matters to be communicated in our report. We have fulfilled the responsibilities described in the Auditor's responsibilities for the audit of the Standalone Ind AS financial statements section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the Standalone Ind AS financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying Standalone Ind AS financial statements.

Key audit matters

How our audit addressed the key audit matter

Revenue Recognition

(as described in note 2.2.c of the standalone Ind AS financial statements)

For the year ended March 31, 2019 the Company has recognized revenue from contracts with customers amounting to 3,371.18 Crores.

Revenue from contracts with customers is recognised when control of the goods or services are transferred to the customer at an amount that reflects the consideration to which the Company expects to be entitled in exchange for those goods or services. The Company has generally concluded that as principal, it typically controls the goods or services before transferring them to the customer.

The variety of terms that define when control are transferred to the customer, as well as the high value of the transactions, give rise to the risk that revenue is not recognized in the correct period.

Revenue is measured net of net of returns and allowances, cash discounts, trade discounts and volume rebates (collectively 'discount and rebates'). There is a risk that these discount and rebates are incorrectly recorded as it also requires a certain degree of estimation, resulting in understatement of the associated expenses and accrual.

Revenue is also an important element of how the Company measures its performance. The Company focuses on revenue as a key performance measure, which could create an incentive for revenue to be recognized before the risk and rewards have been transferred.

Accordingly, due to the significant risk associated with revenue recognition in accordance with terms of Ind AS 115 'Revenue from contracts with customers', it was determined to be a key audit matter in our audit of the standalone Ind AS financial statements.

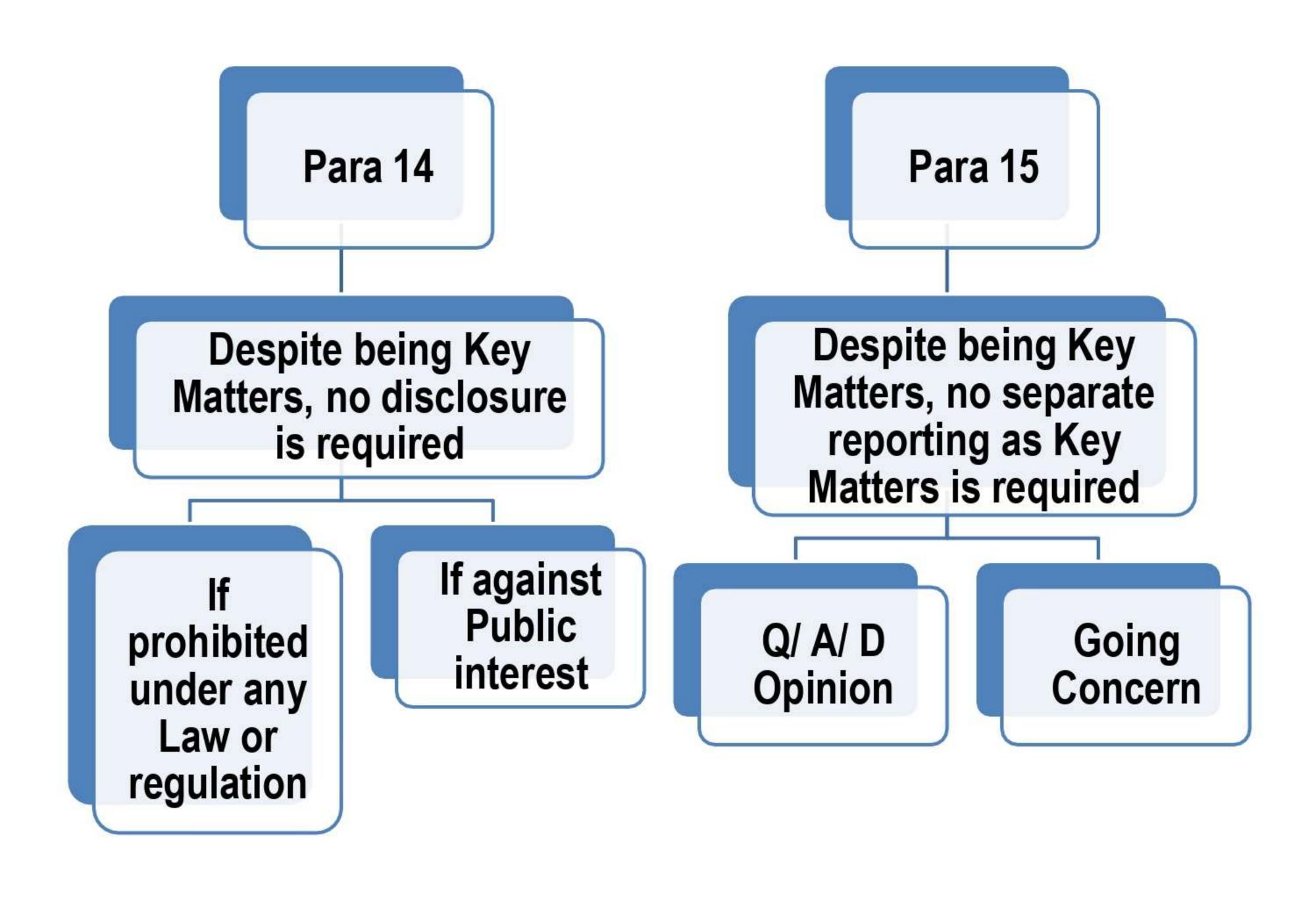
Our audit procedures included the following:

- Assessed the Company's revenue recognition policy prepared as per Ind AS 115 'Revenue from contracts with customers'.
- Assessed the design and tested the operating effectiveness of internal controls related to revenue recognition, discounts and rebates.
- Performed sample tests of individual sales transaction and traced to sales invoices, sales orders and other related documents. Further, in respect of the samples checked that the revenue has been recognized as per the shipping terms.
- To test cut off selected sample of sales transactions made pre- and post-year end, agreeing the period of revenue recognition to third party support, such as transporter invoice and customer confirmation of receipt of goods.
- Tested the provision calculations related to management incentives, discounts and rebates by agreeing a sample of amounts recognized to underlying arrangements with customers and other supporting documents.
- Performed monthly analytical procedures of revenue by streams to identify any unusual trends.
- Obtained confirmations from customers on sample basis to support existence assertion of trade receivables and assessed the relevant disclosures made in the financial statements; to ensure revenue from contracts with customers are in accordance with the requirements of relevant accounting standards.

- Communicating key audit matters in the auditor's report is not a substitute:
 - 1. for disclosures required in F.S. as per FRF;
 - 2. for expression of Q/A/D opinion;
 - 3. for reporting as per SA 570 on Going Concern

How to communicate "Key Audit Matters" [Para 13]

- Use an appropriate subheading, in a separate section of the auditor"s report under the heading "Key Audit Matters";
- Disclose why the matter is considered "Key Audit Matter" and it is being dealt in audit of F.S.;



- ABC Limited (a listed company) is under investigation by SFIO and the investigation proceedings are not yet concluded as on 31st March, 2020.
- The statutory auditor has discussed this fact with TCWG and considers it as a significant matter.
- The SFIO officials have taken undertaking of confidentiality from all the officers and employees of the company for preventing any such disclosure w.r.t. ongoing investigation.
- Whether this matter should be reported as KAM by the statutory auditor

- ABC Limited (a listed company) is under investigation by SFIO and the investigation proceedings are not yet concluded as on 31st March, 2020.
- The information about this investigation has already been disclosed to the Stock Exchanges by the company in terms of Regulation 30 of SEBI-LODR.
- The statutory auditor has discussed this fact with TCWG and considers it as a significant matter.
- Whether this matter should be reported as KAM by the statutory auditor

- RST Limited (a listed company) is engaged in manufacturing of heavy vehicles, combat equipments, defence equipments etc.
- The company was awarded a contract by Ministry of Defence for supplying high speed sustainable combat tanks during the year.
- The revenue from such contract accounts for around 25% of total revenue of the company.
- The statutory auditor has discussed this fact with TCWG and considers it as a significant matter.
- Whether this matter should be reported as KAM by the statutory auditor

- RST Limited. It is subjected to secretarial audit u/s 204 of Co. Act. The auditor asked for secretarial audit report, minutes books and the like from the company
- The company denied to provide the same
- Question: Can the auditor be denied such records (legally)??
- Answer: No
- Section 143(3)(a) whether auditor has sought necessary <u>information and</u> <u>explanation</u>.....
- SA 500 and SA 580:
 - SA 500 audit evidence information
 - SA 580 MRL explanation
 - Section 143(3) & (9), (10) SA need to be complied with mandatorily
 - Auditors have wide rights to have access not only to books of accounts but to books and papers (referred in Sec 128) as well – books and papers include minutes also
 - In Newton vs . Birmingham Small Arms Co, the auditors scope cannot be limited by Management

Documentation

- MRL Covid + Going Concern + estimates of NRV for Inventory + physical stock taking + moratorium given by RBI and availed by the company + subsequent events
- External Confirmations MSMEs + S. Drs. + S. Crs. + Bank (if moratorium facility is availed) + [Lessor + Lessee] w.r.t. changes in lease arrangements
- Litigation (if any) invocation of force majeure clauses + invocation of penalty clauses/ LD clauses for delay in project completion
- NOTE: Section 115BAA ~ new rates if adopted ~ MRL [MAT credit reversal ~ MRL with computation]
- SA 710 last year audit report (if Q/A/D) ~ check whether this year corrective action has been taken or not
- Schedule III investments ~ long term and short term bifurcation

Certain Tax Audit Issues vis-à-vis ICDS

Inventories

Costs of purchase

ICDS AS

the acquisition

The costs of purchase shall consist The costs of purchase shall consist of purchase price including duties of purchase price including duties and taxes, freight inwards and other and taxes (other than those expenditure directly attributable to subsequently recoverable by the enterprise from the taxing authorities), freight inwards and other expenditure directly attributable to the acquisition

Valuation of inventory on dissolution of a partner-ship firm or association of person or body of individuals

ICDS	AS
In case of <u>dissolution of a</u> partnership firm or association of person or body of individuals, notwithstanding whether business is discontinued or not, the inventory on the date of dissolution shall be valued at the net realisable value	N.A.

ICDS-II vis-a-vis Section 145A

- Section 145A has been substituted by the Finance Act, 2018 with retrospective effect from AY 2017-18;
- New Principles:
 - the valuation of inventory shall be made at lower of actual cost or NRV computed in accordance with the ICDSs;
 - 2) the valuation of purchase and sale of goods or services and of inventory shall be adjusted to include the amount of any tax, duty, cess or fee (by whatever name called) actually paid or incurred by the assessee to bring the goods or services to the place of its location and condition as on the date of valuation.
 - 3) Explanation 1 to section 145A clarifies that for the purposes of this section, the expression "any tax, duty, cess or fee (by whatever name called) under any law for the time being in force", shall include all such payments notwithstanding any right arising as a consequence to such payment

Construction Contracts

Retentions

ICDS	AS
Retentions shall be included in contract revenue	Silent

Early stages of completion of contract

ICDS AS During the early stages of a During the early stages of a contract, where the outcome of contract, where the outcome of the contract cannot be estimated the contract cannot be estimated reliably contract revenue is reliably contract revenue recognised only to the extent of recognised only to the extent of costs incurred. The early stage costs incurred. However, of a contract shall not extend definition as to upto what % of beyond 25% of the stage of completion it can considered that contract is at completion early stage

ICDS-III vis-a-vis The Act

- The retention money under Paragraph 10(a) in ICDS-III will have to be determined on a case to case basis by applying settled principles of accrual of income.
- By deploying ICDS-III in a manner that seeks to bring to tax the retention money, the receipt of which is uncertain/conditional, at the earliest possible stage, irrespective of the facts, the Respondents would be acting contrary to the settled position in law - Chamber of Tax Consultants v. Union of India; CIT v. Simplex Concrete Piles India (P) Ltd.
- To overcome the aforesaid precedents, the Finance Act, 2018 has inserted in the Act new section 43CB;
- New section 43CB provides that the contract revenue shall include retention money. Further, it provides that contract cost shall not be reduced by incidental interest, dividend and capital gains.

Revenue Recognition

Taxes collected from buyer/ client whether includible in revenue

ICDS AS ICDS-IV silent in this regard. Amounts collected on behalf of However, section 145A(ii) of the third parties such as sales Act requires that taxes collected taxes, goods and services taxes from buyer on sale of goods or and value added taxes are not services shall be included in the economic benefits which flow to valuation of sale of goods. the entity and do not result in increases in equity. Therefore, they are excluded from revenue.

ICDS-IV vis-a-vis The Act

- Section 145A has been substituted by the Finance Act, 2018 with retrospective effect from AY 2017-18
- Section 145A now provides that the valuation of purchase and sale of goods or services and of inventory shall be adjusted to include the amount of any tax, duty, cess or fee (by whatever name called) actually paid or incurred by the assessee to bring the goods or services to the place of its location and condition as on the date of valuation;
- Deduction for these taxes can be claimed on payment basis u/s 43B;
- Basis of computing income in case of certain service contracts – see next slide

Basis of computing income in case of certain service contracts

Points of comparison	ICDS-IV	New Section 43CB applicable w.e.f. AY 2017-18	Remarks
Basis for computing income from contract for providing services with duration less than 90 days	Revenue may be recognised when the rendering of services under that contract is completed or substantially completed	In the case of a contract for providing services with duration of not more than 90 days, the profits and gains shall be determined on the basis of project completion method.	In view of section 43CB, option under Para 7 of ICDS-II no longer available for service contracts with duration of 90 days or less. Assessee must adopt PCM only

Tangible Fixed Assets

Revaluation

ICDS	AS
Silent	Deals with revaluation in detail.

ICDS-V vis-a-vis The Act

- Section 43(1) of the Act defines actual cost.
- The definition does not specify the criteria as to what expenditures should be included in actual cost (i.e. components of actual cost). For instance, the definition merely specifies that portion of actual cost met by any other person or authority must be excluded from 'actual cost'.
- There are 15 existing Explanations in section 43(1) which specify how actual cost is to be worked out in various situations – some of these explanations are given in the next slide

Interest paid or payable in connection
with the acquisition of asset.

Interest relatable to the period after it was <u>first</u> <u>put to use</u> is not to be included in actual cost.

Portion of cost of asset is met directly or indirectly in the form of subsidy or grant by the Central/State Government/Any other person

Deducted from the actual cost of asset.

In a scheme of amalgamation, asset is acquired by the amalgamated company (which is Indian Company) from the amalgamating company.

Actual cost shall be the same as it would have been had the amalgamating company continued to hold for the purposes of its own business.

- New proviso inserted by Finance Act, 2017 to exclude from actual cost any expenditure involving cash payment above the threshold of Rs. 10,000:
 - where an assessee incurs any expenditure for acquisition of any asset in respect which:
 - a payment or aggregate of payments
 - made to a person in a day,
 - otherwise than by an account payee cheque drawn on a bank or account payee bank draft or use of electronic clearing system through a bank account,
 - exceeds ten thousand rupees,
 - such expenditure shall be ignored for the purposes of determination of actual cost of such asset.

- In case of conflict between ICDS-V and section 43(1), section 43(1) shall prevail
- ICDS-V requires inclusion of all expenditure that meets the criteria in Para 5 of ICDS-V. This is irrespective of mode of payment of expenditure involved.
- However, the new proviso in section 43(1) provides for exclusion from actual cost of cash expenditure above threshold of Rs. 10,000. The new proviso to section 43(1) shall prevail over Para 5 of ICDS-V and the expenditure involving cash payment above Rs. 10,000 shall be excluded from actual cost even if it meets the criteria of Para 5 of ICDS-V

The Effects of Changes in Foreign Exchange Rates

Foreign operations [Foreign Branch]

ICDS

No bifurcation like Integral or Integral foreign operation: non-integral foreign operation

Para 3 to Para 6 of ICDS VI will be applicable for translation of financial statement of all foreign operations.

resulting exchange differences are recognised as income or expense in that previous vear.

AS

Same as ICDS

Non integral foreign operation:

Translation procedure is same; however the difference translation is required to be accumulated in a foreign currency translation reserve (FCTR) and on the disposal of the net investment in foreign operation, it should be recognised as income or as expenses

ICDS-VI vis-a-vis The Act

- Section 43A: changes in actual cost on account of change in the rate of exchange <u>at the time of making payment</u>, in respect of a capital asset, being acquired from a country outside India, shall be capitalised along with the cost of asset;
- Section 43AA: any gain or loss arising on account of effects of changes in foreign exchange rates in respect of specified foreign currency transactions shall be treated as income or loss, which shall be computed in the manner provided in ICDS.
- Scope of Sec. 43AA specified foreign currency transactions:
 - 1) monetary items and non-monetary items;
 - 2) translation of financial statements of foreign operations;
 - 3) forward exchange contracts;
 - 4) foreign currency translation reserves

Marked to Market Loss (MTM)

- The Finance Act, 2018 inserted clause (xviii) in Section 36 which provided that deduction in respect of any marked to market loss or other expected loss shall be allowed, if computed in accordance with the income computation and disclosure standards notified under sub- section (2) of section 145 - effective retrospectively from 1st April 2017, thereby applicable to A.Y. 2017-18;
- By and large the Tribunals and Courts had taken a consistent view with certain exceptions, that MTM loss is allowable business loss, such as:
 - assessee claimed unrealized loss due to forex fluctuation in foreign currency transaction - CIT v. Woodward Governor India (P.) Ltd.
 - losses of marked to market on revaluation and re-statement of pending forward contract for foreign exchange are allowable -Dy. CIT v. Enercon India Ltd.

Marked to Market Loss (MTM)

Section 36(1)(xviii) and ICDS VI:

- In respect of monetary items, such as Cash, receivables, and payables, exchange differences arising on the settlement thereof or on conversion thereof on last day of the previous year shall be recognised as income or as expense in that previous year. It means that the assessee has to recognise both loss or gain on conversion of monetary items existing in foreign currency, into reported currency as per rates on last day of accounting year. Earlier gains used to be ignored in case of settlement prior to maturity date;
- It may be seen that prior to amendment, MTM loss was allowed as deduction whereas MTM gain was ignored on account of prudence. But after amendment not only MTM loss is allowable as deduction like before but MTM gain has also to be offered for taxation.

Government Grants

Recognition of Government Grants

ICDS AS Government grants should not Government grants should not be be recognised until there is recognised until reasonable assurance that: (i) reasonable assurance that: (i) the the person shall comply with the person shall comply with the conditions attached to them, and conditions attached to them, and (ii) the grants shall be received. (ii) the grants shall be received. Recognition of Government grant shall not be postponed beyond the date of actual <u>receipt</u>

Government grant related to a depreciable fixed asset

ICDS AS Where the Government grant Where the Government grant relates to a depreciable fixed relates to a depreciable fixed asset or assets of a person, the asset, the same may be deducted grant shall be deducted from from assets concerned or treated the actual cost of the asset or as deferred income over the assets concerned or from the useful life on a systematic and a written down value of block of rational basis. assets to which concerned asset or assets belonged to. option to recognize deferred income over the useful

life.

ICDS-VII vis-a-vis The Act

Explanation 10 below section 43(1) provides that where a portion of the cost of an asset acquired by the assessee has been met directly or indirectly by the Central Government or a State Government or any authority established under any law or by any other person, in the form of a subsidy or grant or reimbursement (by whatever name called), then, so much of the cost as is relatable to such subsidy or grant or reimbursement shall not be included in the actual cost of the asset to the assessee;

ICDS-VII vis-a-vis The Act

• Clause (xviii) of section 2(24) analyse the scope of the term 'income' to specifically include "assistance in the form of subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement (by whatever name called) by the Central Government or a State Government or any authority or body or agency in cash or kind to the assessee other than the subsidy or grant or reimbursement which is taken into account for determination of the actual cost of the asset in accordance with the provisions of Explanation 10 to clause (1) of section 43"

ICDS-VII vis-a-vis The Act

 New section 145B has been inserted in the Act by the Finance Act, 2018 to provide that income referred to in subclause (xviii) of clause (24) of section 2 shall be deemed to be the income of the previous year in which it is received, if not charged to income tax for any earlier previous year.

Securities

Securities

ICDS	AS
deals with securities held as stock-in-trade	deals with accounting for current investments, long term investments and investment property but excludes shares, debentures or other securities held as stock-in-trade

ICDS-VIII vis-a-vis The Act

- Section 145A of the Act as substituted by the Finance Act, 2018 w.e.f. A.Y. 2017-18 provides that:
 - inventory being securities not listed, or listed but not quoted, on a recognised stock exchange with regularity from time to time, shall be valued at <u>actual cost</u>;
 - inventory being listed securities, shall be valued at <u>lower of</u>
 actual cost or net realisable value in the manner provided in
 ICDS and for this purpose the comparison of actual cost and net
 realisable value shall be done <u>category-wise</u>;
 - inventory being securities held by a scheduled bank or public financial institution shall be valued in accordance with ICDSs after taking into account <u>guidelines issued by the Reserve Bank</u> of India in this regard

Security	Category	Cost	NRV	Lower	ICDS Rs.
Α	Share	100	75	75	
В	Share	120	150	120	
С	Share	140	120	120	
D	Share	200	190	190	
	Total	560	535	505	535
E	Debt Security	150	160	150	
F	Debt Security	105	90	90	
G	Debt Security	125	135	125	
H	Debt Security	220	230	220	
	Total	600	615	585	600
Securities	Total	1160	1150	1090	1135

Borrowing Costs

Exchange differences arising from foreign currency borrowings to the extent regarded as interest costs

ICDS				AS	
These	are	not	treated	as	These are regarded as borrowing
borrowing costs under ICDS			ler ICDS	costs	

Income on temporary investment of borrowed funds which are specifically borrowed for obtaining a qualifying asset

ICDS	AS
No netting off from cost of asset. Will be taxed as income	To be netted off from borrowing costs and capitalised

ICDS-IX (New) vis-a-vis The Act

 Section 36(1)(iii) provides for deduction of amount of the interest paid in respect of capital borrowed for the

purposes of the business or profession;

 The proviso to section 36(1)(iii) provides that any amount of the interest paid, in respect of capital borrowed for acquisition of an asset (whether capitalised in the books of account or not) for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction;

 Proviso to section 36(1)(iii) covers only a situation where funds specifically borrowed for acquisition of an asset. It does not apply to funds borrowed generally and used for acquisition of an asset. ICDS-IX fills in this void.

Provisions, Contingent Liabilities and Contingent Assets

Recognition of provision

ICDS	AS
Provision to be recognised when outflow of resources to settle the obligation is <u>reasonably certain</u>	

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