KPMG

First Notes

QRB issued its report on audit quality review of top listed and public interest entities in India

13 December 2017

First Notes on

Financial reporting

Corporate law updates

Regulatory and other information

Disclosures

Sector

All

Banking and insurance

Information, communication, entertainment

Consumer and industrial markets

Infrastructure and government

Relevant to

All

Audit committee

CFO

Others

Transition

Immediately

Within the next three months

Post three months but within six months

Post six months

Forthcoming requirement

Background

The Quality Review Board (QRB) was formed by the Central Government (CG) in 2007 to perform audit quality review function of top listed and other public interest entities in India. Since August 2012, the QRB has selected 585 quality review assignments for initiating reviews of statutory audits of 443 companies. These companies represent more than 85 per cent market capitalisation of the stocks listed on the National Stock Exchange (NSE) and the Bombay Stock Exchange (BSE). The QRB has finalised 383 review reports till date. Out of these 383 reports, review findings of 257 reports were presented in earlier reports of the QRB.

New development

On 10 November 2017, the QRB issued the 'Report on Audit Quality Review' (2016-17) (the QRB report). The report comprise of key findings of 74 reviews which were completed by the QRB till June 2017. Out of these 74 reviews, 69 reviews pertained to the financial statements for the year ended 31 March 2014 and 5 reviews pertained to the financial statements for the year ended 31 March 2015.

The findings in the report relate to compliance with the requirements prescribed under:

- Standards on Auditing (SA)
- Accounting Standards (AS) and
- Other relevant laws and regulations including:
  - Schedule III to the Companies Act, 2013 (2013 Act)/Revised Schedule VI to the Companies Act, 1956 (1956 Act)
  - Companies (Auditor's Report) Order (CARO)
  - Others such as compliance with erstwhile Listing Agreement with Securities and Exchange Board of India (SEBI), SEBI (Mutual Funds) Regulations and Banking Regulation Act, 1949.

This issue of First Notes provides an overview of the observations of the QRB with respect to AS and Schedule III to the 2013 Act as provided in the report.

Observations of the report

Compliance with AS

The report provided following observations with respect to compliance with the requirements of the respective AS:

- **AS 1, *Disclosure of Accounting Policies***: Disclosure of significant accounting policies followed by the companies in preparation and presentation of financial statements is important as it helps the users of the financial statements understand a company's financial position and financial performance.

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As per the QRB findings, certain companies have failed to disclose all the significant accounting policies adopted in the preparation and presentation of financial statements. Examples of policies that were not disclosed are accounting policy relating to amortisation of computer software, use of estimates, impairment of assets and provisions, contingent assets and contingent liabilities and revenue recognition for services rendered.

- **AS 2, Valuation of Inventories:** Inventories are required to be valued at the lower of cost and Net Realisable Value (NRV) as per AS 2.

  The QRB reported that certain items whose shelf life has expired were not valued at lower of cost and NRV. In another case, the accounting policy mentioned that stock in process has been valued at cost.

- **AS 3, *Cash Flow Statements:*** Economic decisions of the users require an evaluation of the ability of a company to generate cash and cash equivalents and the timing and certainty of their generation. Cash flow statements of a company help the users of financial statements in making such decisions.

  The QRB report has highlighted following discrepancies in the financial statements of certain companies with respect to the requirements of AS 3:

  a) Failure to correctly disclose cash flows arising from operating, investing and financing activities e.g. dividend received on investments disclosed under financing activities.

  b) Failure to properly classify various items of cash flows in cash and cash equivalents.

  c) Failure to disclose the components of cash and cash equivalents and present reconciliation of the amounts in cash flow statement with equivalent items reporting in the balance sheet.

  d) Failure to disclose method of preparation of cash flow statements (i.e. direct or indirect) in the accounting policies followed.

- **AS 9, *Revenue Recognition:*** In certain cases, for example, revenue under the head 'investment management fees and portfolio management', the timing of recognition of revenue has not been specified in the notes to financial statements.

- **AS 11, *The Effects of Changes in Foreign Exchange Rates:*** A rate that approximates the actual exchange rates, for example, an average rate for the period, is often used to translate income and expense items of a foreign operation as per AS 11.

  The QRB reported that income and expenditure items have been converted by certain companies at the year-end rates instead of average rate.

- **AS 12, *Accounting for Government Grants:*** As per AS 12, government grants related to specific fixed assets should be presented in the balance sheet by showing the grant as a deduction from the gross value of the assets concerned in arriving at their book value.

  The QRB report pointed out that the accounting policy of certain companies did not disclose the treatment of grant received against the fixed assets.

- **AS 13, *Accounting for Investments:*** AS 13 requires that carrying amount for current investments should be at lower of cost and fair value. However, the report highlighted that certain companies have valued the current investments at lower of cost and NRV (instead of fair value).

  Additionally, in one case, a provision for other than temporary diminution in the value of long-term investment in subsidiaries has not been created despite of substantial reduction in the company's net worth which were not temporary in nature.

- **AS 15, *Employee Benefits:*** Companies have failed to provide the following information with respect to AS 15:

  a) Amount recognised as an expense for defined contribution plan

  b) Information that enables the users of financial statements to evaluate the nature of its defined benefit plans and the financial effects of changes in those plans.

- **AS 17, *Segment Reporting:*** AS 17 defines 'segment assets' as 'those operating assets that are employed by a segment in its operating activities and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis.'

  The key finding with respect to segment reporting by companies relates to consideration of an asset (bank fixed deposits) as a segment asset where the corresponding income from such an asset has been presented as unallocated which appears to be not in line with the requirements of AS 17. Additionally, in certain cases, disclosures that have been specified for reportable segments have not been provided in the financial statements.

- **AS 18, *Related Party Disclosures:*** As per AS 18, the operating results and financial position of a company could be affected by a related party relationship even if related party transactions do not occur. Additionally, AS 18 states that transactions between related parties may not be effected at the same terms and conditions as between unrelated parties. Therefore, companies are required to make adequate disclosure with respect to related parties and related party transactions.

  The QRB report pointed out that certain companies have failed to disclose the following information in relation to related party:

  a) Related party transactions and volume of such transactions

  b) Names of those related parties for which relationship existed for a part of the year.

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- **AS 19, *Leases:*** In certain cases, disclosures specified with respect to accounting for operating leases (cancellable or non-cancellable) have not been provided in the accounting policies or in the notes to the financial statements.

- **AS 20, *Earnings Per Share:*** In certain cases, companies have failed to disclose the numerator and the denominator used to arrive at the diluted earnings per share and have not provided reconciliation of the amount used as numerator with the net profit for the period.

- **AS 22, *Accounting for taxes on Income:*** As per AS 22, Deferred Tax Assets (DTAs) should be recognised and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income would be available against which such DTAs could be realised.

  Companies are required to disclose the nature of evidence supporting the recognition of DTA, if they have unabsorbed depreciation or carry forward of losses under tax laws.

  Additionally, break-up of DTAs and Deferred Tax Liabilities (DTLs) into major components of the respective balances should be disclosed in the notes to accounts.

  The report highlighted following discrepancies by certain companies in relation to DTA/DTL:

  a) Failure to provide break-up of DTA (net)

  b) Failure to test and review the status of availability of virtual certainty of sufficient taxable income available against the DTA while the company continuing with the DTA existing in the accounts has been conducted.

- **AS 26, *Intangible Assets*:** As per AS 26, an intangible asset should be recognised, if it meets both the given conditions:

  a) It is probable that the future economic benefits that are attributable to the asset will flow to the enterprise and

  b) Cost of the asset can be measured reliably.

  Further, AS 26 prescribes specific disclosures to be made for each class of intangible assets such as useful lives, amortisation rates, amortisation methods, etc.

  The report pointed out following deficiencies with respect to recognition and disclosure of intangible assets:

  a) Failure to capitalise certain intangible assets.

  b) Failure to disclose amortisation period of certain intangible assets in the accounting policy.

- **AS 28, *Impairment of Assets:*** A company is required to assess at each balance sheet date whether there is any indication that an asset may be impaired as per AS 28.

  The QRB report highlighted that in case of certain companies such an assessment was not made despite the fact all fixed assets were not in use for long period and could indicate an impairment.

- **AS 29, *Provisions, Contingent Liabilities and Contingent Assets:*** AS 29 requires recognition of a provision in case all the following conditions are met:

  a) An enterprise has a present obligation as a result of a past event

  b) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and

  c) A reliable estimate can be made of the amount of the obligation.

  A company is not required to recognise a contingent liability. However, specified disclosures are to be made unless the possibility of any outflow in settlement of such a liability is remote.

  Key findings of the report with respect to recognition of provisions and disclosures of contingent liabilities are as follows:

  Provisions

  a) Failure to provide an appropriate provision for accrued liabilities made

  b) Failure to disclose timing of outflow, uncertainties about outflows and expected reimbursement of the provisions for liabilities.

  Contingent liabilities

  a) Failure to disclose contingent liabilities for disputed tax liabilities

  b) Failure to disclose indication of the uncertainties relating to any outflow and the possibility of any reimbursement in case of contingent liabilities.

Compliance with Schedule III to the 2013 Act

With respect to compliance with Schedule III to the 2013 Act, the QRB report has, *inter alia,* reported following discrepancies:

a) Non-disclosure of rate of interest in case of borrowings (long-term and short-term).

b) Failure to sub-classify ‘other current assets’ into secured or unsecured and considered good or doubtful in the audited balance sheet.

c) Debentures have not been shown in the order of maturity in the balance sheet.

d) Failure to disclose loan repayable on demand in the schedule of borrowings.

e) Audit fees of subsidiaries and joint ventures have been shown under professional fees rather than disclosing them separately under ‘audit fees’ in the consolidated balance sheet.

f) Debts due from parties beyond six months have been disclosed but not for the debts due for more than six months from the dates these debts have fallen due for payment.

g) Amount of depreciation and amortisation expenses appearing in the statement of profit and loss does not match with the amount mentioned in the fixed assets note.

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Our comments

The QRB report has highlighted various common but very important areas to be considered while preparing the financial statements of companies. Companies which have not been reviewed by the QRB should also carefully consider the review points/issues highlighted as these could be applicable to them as well.

The QRB could consider expediting its review process as many companies have now transitioned to Indian Accounting Standards (Ind AS). Companies would be interested to know the common areas of improvements in the financial statements prepared under Ind AS.

Additionally, the Report of the Committee on Corporate Governance published on 5 October 2017 also recommends that QRB should be further strengthened to meet the independence criteria laid down by the International Forum of Independent Audit Regulators (IFIAR) and should become a member of IFIAR. The QRB should consider to increase the size of its full time personnel and should also take steps to further its operational independence.

Internationally, similar precedents/practices exist. For instance, the European Securities and Markets Authority (ESMA) as part of its procedures also examines financial statements of various companies to promote a consistent application of International Financial Reporting Standards (IFRS) across the European Union. Recently, it has issued its annual public statement and identified financial reporting topics which listed companies and their auditors should particularly consider while preparing and auditing the financial statements for the year ended 2017. The common enforcement priorities for the 2017 year-end outlined by ESMA are as follows:

a) Disclosure of the expected impact of implementation of major new standards in the period of their initial application (i.e. IFRS 9, *Financial Instruments*, IFRS 15, *Revenue from Contracts with Customers* and IFRS 16, *Leases*)

b) Specific recognition, measurement and disclosure issues of IFRS 3, *Business Combinations*

c) Specific issues of IAS 7, *Statement of Cash Flows.*

Companies in India who have transitioned to Ind AS or are in the process of doing so are also encouraged to take note of the recommendations provided by ESMA as these are expected to help them in better preparation and presentation of financial statements.

The bottom line

Companies should analyse their financial statements and take note of the comments raised by the QRB.

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Ahmedabad
Commerce House V, 9th Floor
902 & 903, Near Vodafone House
Corporate Road, Prahaladnagar
Ahmedabad 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru
Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala, Bengaluru 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh
SCO 22-23 (Ist Floor)
Sector 8C, Madhya Marg
Chandigarh 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai
KRM Tower, Ground Floor,
No 1, Harrington Road
Chetpet, Chennai – 600 031
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Gurugram
Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurugram, Haryana 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Noida
Unit No. 501, 5th Floor,
Advant Navis Business park
Tower-B, Plot# 7, Sector 142,
Expressway Noida, Gautam Budh Nagar,
Noida – 201305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Hyderabad
Salarpuria Knowledge City,
ORWELL, 6th Floor, Unit 3, Phase III,
Sy No. 83/1, Plot No 2,
Serilingampally Mandal, Raidurg
Ranga Reddy District,
Hyderabad, Telangana – 500081
Tel: +91 40 6111 6000
Fax: +91 40 6111 6799

Kochi
Syama Business Centre
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata
Unit No. 603 – 604, 6th Floor, Tower - 1, Godrej Waterside, Sector – V,
Salt Lake, Kolkata - 700 091
Tel: +91 33 44034000
Fax: +91 33 44034199

Mumbai
Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Pune
9th Floor, Business Plaza
Westin Hotel Campus, 36/3-B
Koregaon Park Annex, Mundhwa Road
Ghorpadi, Pune 411 001
Tel: +91 20 6747 7000
Fax: +91 20 6747 7100

Vadodara
iPlex India Private Limited,
1st floor office space, No. 1004,
Vadodara Hyper, Dr. V S Marg
Bund Garden
Vadodara 390 007
Tel: +91 0265 235 1085/232 2607/232 2672

Jaipur
Regus Radiant Centres Pvt. Ltd.
Level 6, Jaipur Centre Mall
B2 By Pass Tonk Road
Jaipur, Rajasthan 302 018
Tel: +91 141 710 3224

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The website provides information and resources to help board and audit committee members, executives, management, stakeholders and government representatives gain insight and access to thought leadership publications that are based on the evolving global financial reporting framework.

IInd AS Transition Facilitation Group (ITFG) issues Clarifications Bulletin 12

8 November 2017

The ITFG in its meeting considered certain issues received from the members of the ICAI and issued its Clarification Bulletin 12 on 23 October 2017 to provide clarifications on 11 issues in relation to the application of Ind AS.

This issue of IFRS Notes provides an overview of the clarifications issued by ITFG through its Bulletin 12.

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Missed an issue of Accounting and Auditing Update or First Notes

Issue no. 16 – November 2017

The topics covered in this issue are:

- Accounting for revenue is changing, are you ready?
- Recognition of interest income and impairment allowance for credit-impaired assets
- Restructuring of companies under the Companies Act, 2013
- Equity accounting under Ind AS
- Regulatory updates

ICAI issues exposure drafts of AS 23, *Borrowing Costs* and AS 24, *Related Party Disclosures*

1 November 2017

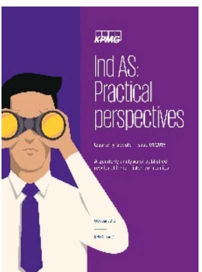
On 5 October 2017, the ASB of the ICAI issued Exposure Drafts (EDs) of the following AS:

a) AS 23, *Borrowing Costs*

b) AS 24, *Related Party Disclosures.*

This issue of First Notes provides an overview of guidance contained in the ED of AS 23 and ED of AS 24. The note also highlights the areas of key difference between the EDs and the currently applicable AS (i.e. AS 16, *Borrowing Costs*, and AS 18, *Related Party Disclosures* respectively).

It is important to note that ED of AS 23 and AS 24 is not identical to Ind AS 23, *Borrowing Costs* and Ind AS 24, *Related Party Disclosures* respectively. Therefore, this First Notes also highlights additional requirements contained in Ind AS 23 and Ind AS 24.



Ind AS - Practical perspectives

KPMG in India's Ind AS - Practical perspectives through aims to put a finger on the pulse of India Inc's adoption of Ind AS and capture emerging trends and practices.

Our impact assessment is based on Nifty 50 companies which would be the first group of companies to report Ind AS results. The Nifty 50 companies have declared their financial results for the year ended 31 March 2017.

Out of the companies comprising Nifty 50 index, eight companies are banks, two are Non-Banking Financial Companies (NBFCs) and two companies follow a different date of transition to Ind AS. Therefore, our analysis would comprise the remaining 38 companies.

This can be accessed on KPMG in India website - **'Ind AS- Practical perspectives' webpage**

Feedback/queries can be sent to aaupdate@kpmg.com

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