Commonly found Non-compliances

Schedule II & III of Companies Act, 2013

Financial Reporting Review Board (FRRB)
Institute of Chartered Accountants of India (ICAI)

Coverage

Schedule II: Key Concepts

- Non Compliances Observed

Schedule III: Key Concepts

- Non Compliances Observed in Division II
- Non Compliances Observed in Division I

Key Concepts
Schedule II to Companies Act, 2013

- **Depreciation** is the systematic allocation of the Depreciable amount of an asset over its useful life.
- Schedule II to the Companies Act 2013 lists down the useful life of the Assets which the Company needs to follow for the purposes of calculation of the Depreciation
- Any changes in the Useful Life from those mentioned in Schedule II must be backed by technical evaluations and disclosed adequately in the Accounting policies for the reader to under stand the chare of depreciation

Some of the key changes in Schedule II to the Companies Act, 2103 are as follows:

- Schedule II prescribes indicative useful lives of various assets instead of Straight Line Method (SLM)/ Written Down Value (WDV) rates for calculating depreciation.
- Useful life is the period over which an asset is expected to be available for use by an entity, or the number of production or similar units expected to be obtained from the asset by the entity.
- Companies are allowed to follow different useful lives/ residual value if an appropriate justification is given, supported by technical advice.
- No separate rate for double/ triple shift; depreciation to be increased based on the double shift/ triple shift use of the assets
- No reference to depreciation on low value assets.
- Component accounting and useful life of a significant part of an asset to be determined separately.

Component accounting:

- Where cost of a part of the asset is significant to total cost of the asset and useful life of that part is different from the useful life of the remaining asset, useful life of that significant part shall be determined separately. It is called as component accounting.
- The determination as to whether a part of an asset is significant requires a careful assessment of the facts and circumstances.
- Component accounting is required to be done for the entire block of assets as at 1 April 2014 if a company opts to follow it voluntarily and as at 1 April, 2015 mandatorily. It cannot be restricted to only new assets acquired after 1 April 2014 or 1 April, 2015 as the case may be.
- Earlier, companies need to expense replacement costs in the year of incurrence. However, under component accounting, companies will capitalize these costs as a separate component of the asset.

Non Compliances regarding Schedule II to Companies Act, 2013

Case:-

The accounting policy on depreciation on Property, Plant and Equipment reads as follows:

“Property, plant and equipment

……..(ii) **Depreciation:** Depreciation on property, plant & equipment is provided on Straight Line Method over their useful lives and in the manner specified in Schedule II to the Companies Act, 2013. **However, in respect of certain Plant & Machineries and Electric Installations, depreciation is provided as per their useful lives assessed on the basis of technical evaluation by the external valuer, ranging from 20 to 40 years**.”

Case:

From the accounting policy on depreciation given in the annual report of a company, it was noted that management re-estimated the useful lives of all fixed assets in 20xx. While comparing the lives estimated by management vis-a-vis lives indicated under Schedule II to Companies Act, 2013, it was noted that in certain cases the lives estimated by management are different from the lives prescribed under Schedule II to Companies Act.

Case:

From the Note on Fixed Assets of a Company, it was noted that the assets were transferred on April 29, 2xxx but the depreciation charged on such assets is reported as Rs. Nil.

Case:

Some of the assets of the company were depreciated based on estimated useful lives different from the useful life specified in the Schedule II.

Key Concepts
Schedule III to Companies Act, 2013

- **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).
- Schedule III (Division II) prescribe format for Ind-AS compliant financial statements.

- 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.

- 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.

- 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 compliances observed pertaining to Division II of Schedule III

- One of the key requirements of Schedule III Division II is that the figures in the financial statements must not be disclosed in full figures
- Depending upon the turnover of the company, the figures appearing in the Financial Statements shall be rounded off as below:
- Turnover Rounding off

(i) less than one hundred crore rupees	-	To the nearest hundreds, thousands, lakhs or millions or decimals thereof.
(ii) one hundred crore rupees or more	-	To the nearest, lakhs, millions or crores, or decimals thereof.

- Once a unit of measurement is used, it should be used uniformly in the Financial Statements.
- Therefore necessary care needs to be taken that full figures are not be presented as the words in the paragraph above is "Shall be rounded off"

Case:

It was noted from the notes to the accounts that the corporate guarantees issued to banks and financial institutions has been disclosed under the heading of contingent liabilities.

Case:

It was noted from Related Party Disclosure, that Receivable from redeemable preference share pertains to an enterprise controlled by the company and it is a related party. However, under the Note regarding Receivable from redeemable preference shares the specified receivables has not been classified as due from related party.

Case :-

It was observed that the loans from related parties had been appearing as line item under the Note on Long term borrowings, however, the terms of repayment has not been disclosed.

Case :

From the financial statements of a company, it was noted that there are various defaults in the repayment of loans. Further, under paragraph (viii) of annexure to auditor's report, the auditor has reported that there has been delay in timely repayment of dues to banks for ECB and to financial institution for debentures, and in respect of working capital facilities from Banks there has been over drawings in the accounts during the year as well as at year end. Under 'Remark' column, the auditor has reported the status of payment of these defaults, according to which, certain dues were unpaid and certain dues were paid before the signing date

Case :

It was noted from notes to the accounts that certain amount of external commercial borrowing is due in next 12 months. However, no disclosure was found for current maturities of long term debts under current liabilities.

Case :

It was noted that the Company has disclosed a line item namely, gain on fair valuation of derivatives under the schedule of Other Income.

Case :

The company under review is engaged in the business of trading and manufacturing of certain goods and it has its own manufacturing facility. However, in the Statement of Profit and Loss, the cost of material consumed has not been disclosed separately instead the same has been clubbed under ‘Purchases of Stock in Trade and Raw Material’ and ‘Changes in Inventories of Finished goods and Stock-in-trade’.

Case: -

From the Note on Other Equity, it was noted that there are various reserves, however, nature and purpose of these reserve has not been mentioned.

Case : -

It was noted from the financial statements that the significant balance of other advances has been disclosed as doubtful.

Case :-

It was noted from notes to the accounts that the trade receivables have been disclosed as doubtful.

Case :

It was noted from Notes to the accounts that Financial Assets in the form of investment in shares of other companies have been wrongly disclosed under Inventories.

Case : -

It was noted that the investments in Subsidiaries, Associates and Joint ventures have been disclosed separately from other than financial assets.

Case : -

It was noted that *other bank balances* have been disclosed under the head of Balance with Banks. Further, it was also noted that the amount is material.

Case:-

It was noted from the financial statements that the fixed deposits with banks having maturity period of more than 12 months have been classified as investments.

Case :-

From the Note on Investments, it was noted that the investments were classified as unquoted investments. The aggregate investment amount and the aggregate impairment value were not disclosed.

Case : -

Under the Note on Loans as given in the financial statements of the company, the line items appeared as follows:-

a. Loans & Advances To Related Parties

b. Loans And Advance To Employees

c. Forward income Receivables

d. Other Advances (constituting significant amount)

e. Interest Accrued on FDR

Case: -

It was noted from the financial statements that no disclosure has been made about the CSR activities.

Case: -

It was noted from the notes to the accounts that deduction of interest on prematurity of FDR has been included in the finance cost.

Non compliances observed pertaining to Division I of Schedule III

Principle:

Paragraph 6A (d) & (e) of General Instructions for Preparation of Balance Sheet of Part I, Schedule III to Companies Act, 2013.

Share Capital Disclosures' given in the Annual Report of some companies

Reconciliation of each class of shares outstanding at the beginning and at the end of the period, was not disclosed.

Principle:

Paragraph 6A(b), (f), (k) of General Instructions for Preparation of Balance Sheet of Part I, Schedule III to Companies Act, 2013.

Share Capital Disclosures' given in the Annual Report of some companies

Under the Disclosure regarding shareholders holding more than 5% shares, it is stated that "a company" is holding more than 51% shares.

Unpaid calls shown as receivable without adequate disclosure.

Share Application Money pending for allotment reflected as part of Share Capital

Principle:

Paragraph 6 B (i) of General Instructions for Preparation of Balance Sheet of Part I, Schedule III to Companies Act, 2013.

Reserve and Surplus Disclosures' given in the Annual Report of some companies,

For each of the specified head of reserves & Surplus, **only the final amount at the end of the period were reflected, without disclosing movement during the year**

Appropriations from Profit for the year were reflected on the face of the Statement of Profit and Loss.

Debit Balance of Statement of Profit and loss was reflected on Assets side of the Balance Sheet

Principle:

Paragraph 6 C, 6 G of General Instructions for Preparation of Balance Sheet of Part I, Schedule III to Companies Act, 2013.

Note on Long Term Borrowings and Short Term Borrowings' given in the Annual Report of some companies,

Secured Borrowings includes loan availed by creating charge on the property of a director and his personal security.

Current Maturities of Long Term Borrowings were reflected as Short Term Borrowings

Bonds/ Debentures were disclosed with the type of bonds/ debentures and rate of interest only

Principle:

Paragraph 6 C, 6 F (i) of General Instructions for Preparation of Balance Sheet of Part I, Schedule III to Companies Act, 2013.

Note on Long Term Borrowings and Short Term Borrowings' given in the Annual Report of some companies,

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 "

Principle:

Paragraph 6 F (i) of General Instructions for Preparation of Balance Sheet of Part I, Schedule III to Companies Act, 2013.

Note on Trade payable' given in the Annual Report of some companies

Trade Payables includes dues payable in respect of statutory obligations like PF, dues towards purchase of fixed assets and other contractual obligations.

Principle:

Paragraph 6 E & H of General Instructions for Preparation of Balance Sheet of Part I, Schedule III to Companies Act, 2013

Note on Provisions' given in the Annual Report of some companies,

it was observed that valuation of Gratuity/ Leave Encashment done by Actuary, provided current and non-current portion for both, but Gratuity was classified as Long Term Provision and Leave Encashment was classified as Short Term Provision.

Principle:

Paragraph 6 I & J of General Instructions for Preparation of Balance Sheet of Part I, Schedule III to Companies Act, 2013

Note on Fixed Assets' given in the Annual Report of some companies,

A company having Tangible and Intangible assets did not categorize the same accordingly.

Advance given for Capital Asset where the work is under progress was included in Capital Work in Progress.

Tangible Assets included owned assets as well as leased assets,

Principle:

Paragraph 6 K of General Instructions for Preparation of Balance Sheet of Part I, Schedule III to Companies Act, 2013

Note on Investments' given in the Annual Report of some companies,

Investment in Associate and Joint Venture was not disclosed, though such disclosure was made in Related Party Transactions.

Investment in Partnership Firms included investment in LLPs

Principle:

Paragraph 6 O of General Instructions for Preparation of Balance Sheet of Part I, Schedule III to Companies Act, 2013

Note on Inventories' given in the Annual Report of some companies,

Trading Stock of the Company which was into manufacturing and trading activities, was included in Finished Goods Stock.

Goods in Transit including towards Raw Materials, Stock-in-trade and Stores and spares, was disclosed together as such.

Principle:

Paragraph 6 P of General Instructions for Preparation of Balance Sheet of Part I, Schedule III to Companies Act, 2013

Note on Trade Receivables' given in the Annual Report of some companies

Trade Receivables outstanding for more than six months were considered from the date of invoice.

Trade Receivables included receivables due from sale of Fixed Assets and Investments.

Principle:

Paragraph 6 Q of General Instructions for Preparation of Balance Sheet of Part I, Schedule III to Companies Act, 2013

Note on Cash & Cash Equivalent' given in the Annual Report of some companies

Fixed Deposits having maturity beyond 12 months were disclosed under this head.

Balance in Unpaid Dividend Account was included in Balances with Banks under the Cash & Cash Equivalents.

Principle:

Paragraph 6 L & R of General Instructions for Preparation of Balance Sheet of Part I, Schedule III to Companies Act, 2013

Note on Loans and Advances' given in the Annual Report of some companies, it was observed that:

- **Provision for Bad and Doubtful Advances were disclosed in aggregate for all types of Loans and Advances.**
- **Loans and Advances to Related Parties were not disclosed separately under the head Loans and Advances,**

When we are no longer able to change a situation,

we are challenged to change ourselves.

Viktor E Frankl

THANK YOU