



NANGIA & CO LLP  
CHARTERED ACCOUNTANTS

# Assurance Gazette

July 2023



## Foreword

We are delighted to bring to you Assurance Gazette – July 2023. This Gazette provides you with insights or key announcements released by regulatory authorities – NFRA & ICAI in the last month that are extremely relevant for the Companies and the professional Firms from financial reporting and auditing perspective.

As part of the publication, we have explained in detail the circular issued by NFRA highlighting instances of non-compliances around revenue recognition and trade receivables that shall help the corporates to reassess the current accounting policy from the circular perspective and take corrective actions if required.

Further, we wish to bring to our reader's attention the recent release by ICAI comprising formats and templates that may be used in statutory audit engagements by professional and audit Firms. In light of recent orders issued by various regulatory authorities questioning the quality, procedures and documentation around audit, this act as a ready reckoner and a valuable resource to be used by audit Firms in improvising the existing quality of audit and keep the stakeholder's confidence intact in the audit itself and the audited financial statements.

We aim to provide you timely information on recent accounting and auditing related updates in a lucid manner.

Hope you will find it useful and informative. Wishing your health and happiness!!

We would be delighted to receive feedback/suggestions from you on any topic that you wish us to cover in our forthcoming publications.





## **Circular issued by National Financial Reporting authority (NFRA) on instances of non-compliance with Ind-AS on accounting policies for measurement of Revenue from Contracts with Customers and Trade Receivables**

As per sub-section 2(b) of section 132 of the Companies Act 2013 (the Act) read with rule 4(2)(c) of the National Financial Reporting Authority Rules 2018 (NFRA Rules 2018), the National Financial Reporting Authority is mandated to monitor and enforce compliance with accounting standards and auditing standards. Further, NFRA is required by sub-section 2(d) of section 132 of the Act read with rule 4(2) (g) of NFRA Rules, to perform such other functions and duties as may be necessary or incidental to the aforesaid functions and duties.

NFRA monitors compliance with accounting standards by Companies as part of its review of published financial statements of companies. During its recent review, instances of apparent non-compliance with the prescriptions of the Ind ASs in the critical areas of Revenue Recognition and Measurement, and Initial Measurement of corresponding Trade Receivables was observed by NFRA.

The following is the observations given in the circular :

### **Para 46 of Ind AS 115, Revenue from Contracts with Customers :**

The above para requires that the entity shall recognize as revenue the amount of the transaction price, excluding the estimates of variable consideration that is allocated to that performance obligation. However, it has been noticed that the significant accounting policies disclosed by many companies wrongly state that revenue is recognized and measured at fair value of the consideration received or receivable.

One example of such erroneous accounting policy of a large, listed company, as observed by NFRA, states as follows

***"...Revenue is measured at the fair value of consideration received or receivable taking into account the amount of discounts, incentives, volume rebates, and outgoing taxes on Sales... .... "***

An example of correct accounting policy stated by a company is as follows:

***".. Revenue towards satisfaction of a performance obligation is measured at the amount of transaction price (net of variable consideration) allocated to that performance obligation. The transaction price of goods sold, and services rendered is net of variable consideration on account of various discounts and schemes offered by the Company as part of the contract... "***

It is important to note that the transaction price defined in appendix A to Ind AS 115 is different from 'fair value' defined in Ind AS 113 and Ind AS 32, Financial Instruments: Presentation. Under Ind AS 115, the application of fair value is relevant only in a limited set of situations; for example, under para 66 of Ind AS 115, where the customer promises consideration in a form other than cash, an entity shall measure the non-cash consideration at fair value.

### Trade receivables: Initial Measurement

Trade receivables are financial assets within the scope of measurement requirements of Ind AS 109, Financial Instruments. All financial assets are required to be initially measured at fair value plus or minus the transaction costs. However, those financial assets classified as 'fair value through profit or loss' are required to be measured at fair value (para 5.1.1 of Ind AS 109). Further, as an exception to these principles, according to para 5.1.3 read with para 5.1.1 of Ind AS 109, financial assets in the accordance with receivables, shall be initially measured (initial recognition amount) at their transaction price (as defined in Ind AS 115) unless those contain a significant financing component determined in accordance with Ind AS 115 (or when the entity applies the practical expedient in accordance with para 63 of Ind AS 115).

It has, however, been noticed that many companies in their accounting policy, either stated separately for trade receivables or stated as part of the accounting policy for financial assets which include trade receivables, are erroneously stating that the trade receivables are initially recognized (or measured) at fair value, which is contrary to the requirements of Ind AS 109.

One example of such erroneous accounting policy stated by a large, listed company is as follows:

***"Trade receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method less provision/or impairment."***

Further, there have also been instances of inconsistency between the accounting policy for initial measurement of trade receivables and the accounting policy for measurement of corresponding revenue leading to misleading and confusing information to the users of the financial statements. An example of such inconsistent accounting policy stated by a company is as follows:

### ***"Financial Assets***

#### ***Initial Recognition and Measurement***

***All financial assets are recognized initially at fair value plus, in the case of financial assets not recorded at fair value through profit or loss, transaction costs that are attributable to the acquisition of the financial assets. These include trade receivables, cash and cash equivalents, other bank balances, fixed deposits with banks, investments, loans and other financial assets.... "***

### **"Revenue Recognition**

***Revenue is recognized to depict the transfer of promised products or services to customers. Revenue is measured based on the consideration to which the Company expects to be entitled in a contract with a customer and excludes amount collected on behalf of third party... "***

One such example of a correct accounting policy disclosed by a company is as follows.

### **"Financial Assets**

***..All financial assets are recognized initially at fair value, plus in the case of financial assets not recorded at fair value through profit or loss (FVTPL), transaction costs that are attributable to the acquisition of the financial asset..... However, trade receivable that do not contain a significant financing component are measured at transaction price. "***

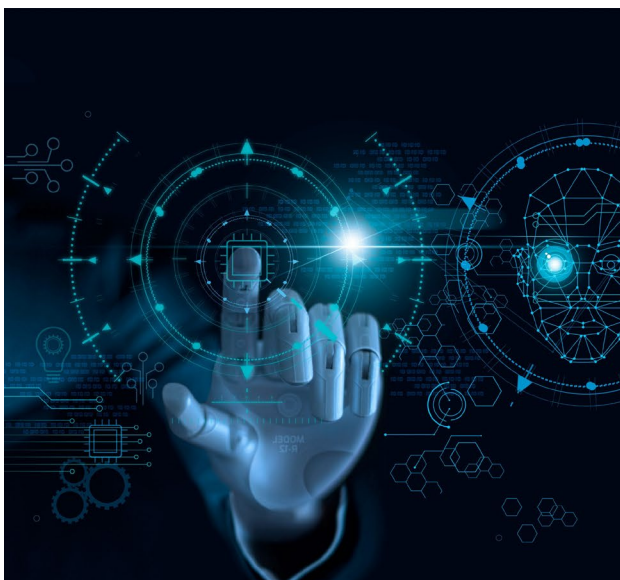
### **"Revenue Recognition**

***..Revenue towards satisfaction of a performance obligation is measured at the amount of transaction price (net of variable consideration) allocated to that performance obligation. The transaction price of goods sold and services rendered is net of variable consideration on account of various discounts and schemes offered by the Company as part of the contract... "***

## **Analysis of the circular**

In recent years, reporting authorities around the world have placed an increasing emphasis on the compliance of accounting standards. Recognizing the critical role that accurate and transparent financial reporting plays in maintaining market integrity and investor confidence, authorities have implemented stringent measures to ensure that organizations adhere to established accounting standards.

Reporting authorities are aware that adherence to accounting standards fosters comparability and consistency in financial reporting, enable investors and stakeholders to make informed decisions. By establishing a common framework for financial reporting, accounting standards facilitate transparency, ensuring that financial information is presented in a clear and meaningful manner. This, in turn, promotes trust in the financial markets and enhances the efficiency of capital allocation.



### **Nangia's Take**

Regulators worldwide have recognized the critical importance of compliance with accounting standards in safeguarding the integrity and stability of financial markets. By ensuring organizations adhere to these standards, they aim to promote transparency, comparability, and investor confidence. Through rigorous oversight and enforcement, they strive to create an environment where accurate financial reporting is the norm, benefiting all stakeholders.





## Audit Working Paper Templates released by ICAI

### Background

Audit documentation (audit working papers) is considered as the backbone of an audit. Standard on Auditing (SA) 230, “Audit Documentation” prescribes the basic principles of audit documentation. The templates of various audit work papers which are required to be prepared by auditors during the course of their audit assignment in accordance with the requirements of Standards on Auditing. Auditors are also required to prepare other audit work papers in respect of audit work done by them pursuant to applicable legal and regulatory requirements.

### Brief Facts

The Institute of Chartered Accountants of India (ICAI) has issued for the first-time audit work papers templates on 3<sup>rd</sup> July, 2023 which will act as a ready database for Chartered Accountant Firms to be adopted and create a robust documentation towards the audit engagements handled by them. Audit documentation and audit procedures were always in existence however there were no defined templates or formats available for ready use which led to varied practices and inconsistency in level of audit workings maintained by different Firms.

Larger Firms had inbuilt or external audit tools or databases created by their knowledge team to adhere to however smaller and medium Firms struggled for such database and could not create a very robust documentation towards audit done by them if they intended to.

This database will act as a ready reference for professional and audit Firms and bring uniformity in the audit workpapers maintained and completing the audit engagement. Further, conducting audit and adhering to such workpapers will enable professional Firms to justify and present the audit workpapers in a quality form which will enable them to obtain easy clearances or reduce frictions when exposed to various regulatory authorities like peer review, NFRA, SEBI inquiries, etc.

Audit work papers are written record of audit procedures performed, the findings and the conclusions reached by the auditor. SA 230 emphasizes the importance of audit documentation as evidence that the audit was planned and performed in accordance with the SA and applicable legal and regulatory requirements.

First and foremost, audit work papers provide evidence of the work carried out and the basis for the auditor’s opinion. It also help the auditor or reviewer to gain confidence that the quality of the audit was up to mark if a record of the audit procedures is maintained along with the evidences. Other advantages of audit work papers are:

- Auditors will be able to demonstrate that the audit was performed in accordance with standards on auditing.
- Audit work papers also serve as a reference point for future audits.
- Audit work papers also facilitate communication among the engagement team members. They provide a common reference point to discuss their findings, conclusions and issues involved.

Following are few important audit working paper templates:

- Appointment- ADT-1, Engagement Letter, Independence Confirmations etc.
- Planning- Audit Strategy, Planning Scope of Engagement, Work Allocation etc.
- Execution- Property, Plant and Equipment, Investments, Other Equity etc.
- Other Procedures- Going Concern, Laws and Regulations, Subsequent Events, ESOPS, etc.
- Financial Reporting- Accounting Policies, Schedule III Checklist, CARO Checklist etc.
- Completion Section- Audit Issues and Closure, Management Representation Letter, Closure, Procedures for Client's Documents etc.

Refer link <https://icai.org/post/audit-working-paper-templates> for detailed PDF and word templates.

### **Nangia's Take**

The intent behind this guidance is that such templates will help in bringing consistency and make it easier for auditors to prepare audit file. This can also help auditors in saving time by providing a structure for the audit work papers and be more efficient and reduce the time required. These templates will need to be used considering the size and complexity of the entity under audit and professionals may use their judgement if they need to make any change in a particular work paper as per the requirements.

Considering the increase in inspections of audit quality and documentation by various regulatory authorities in the recent past, introduction of this database by ICAI is seen as a huge welcoming step winning confidence of such authorities and helping professional Firms to continue their audit engagements in an improvised manner without involving huge additional time and cost at their end.

## Meet our Experts



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