Revision of Financial Statements in India

Unlike the erstwhile Companies Act, 1956, the Companies Act, 2013 ('the 2013 Act') has introduced new provisions related to re-opening/revision/restatement of financial statements (FS) for companies. Earlier in 2003, Ministry of Corporate Affairs (MCA) had issued a circular to clarify that a company could reopen or revise its accounts after the Financial Statements have been approved in Annual General Meeting (AGM) only in order to comply with technical requirements of any law to achieve the objective of exhibiting true and fair view[1]. The revised annual accounts were then required to be adopted either in the extraordinary general meeting or in the subsequent Annual General Meeting and filed with the Registrar of Companies. In other cases, the accounts could not be revised after the approval of accounts in AGM. Eventually, ICAI issued Standard on Auditing (SA) 560, "Subsequent Events" applicable for audits of financial statements for periods beginning on or after April 1, 2009, providing guidance to auditors in situations when some material facts become known to the auditor, which may have caused the auditor to amend the auditor's report, before the date the Financial Statements were issued as well as after the date the Financial Statements have been issued (i.e. the date that the auditor's report and audited financial statements are made available to third parties). Read on to know more.....

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Introduction of New Provisions

Despite several guidances issued earlier, there was a need for clear statutory recognition of revision of accounts in India, especially in cases relating to fraud. The recasting of Financial Statements was ordered by court in Satyam case, which also brought the need to enforce changes in the Companies Act.

[1] Annexure A provides the list of circulars/guidance issued related to revision of FS, prior to introduction of Companies Act, 2013.

It is worthwhile to note that in June 2016, sections related to re-opening of accounts and revisions to Financial Statements under the 2013 Act were notified. These sections became effective along with the constitution of National Company Law Tribunal (NCLT) and National Company Law Appellate Tribunal (NCLAT). On constitution of the NCLT, the Company Law Board (CLB) was dissolved and matters/proceedings/cases pending before CLB as on 1st June 2016 have been transferred to NCLT. An overview of these sections is given below:

- Section 130 deals with compulsory revision/ reopening of accounts of a company on an order by the competent Court or Tribunal if it was found that earlier accounts were prepared in fraudulent manner or financial statements are not reliable due to mismanagement of affairs of the company. Such order can be passed upon, only on application by statutory authorities (Central Government, Income-tax authorities, the Securities and Exchange Board and others). Section 130 does not specify any period upto which the order u/s 130 for re-opening of accounts could be passed.
- Section 131 deals with voluntary revision of financial statements or revision of Board's report in respect of any of the *three preceding financial years**, after obtaining approval by the Board Of Directors (BOD) from the Tribunal. This section allows the directors to revise financial statements or revise board's report, if it appears to the BOD that the company's financial statement or Board's report did not comply with the requirements of Section 129 or 134 of the 2013 Act, relating to compliance with Accounting Standards, form of financial statements, mandatory disclosures in the board's report etc.

  Section 129 relates to compliance with Accounting Standards notified u/s 133, form of financial statements for different classes of companies as per Schedule III and providing true and fair view of the state of affairs of the companies for standalone as well as consolidated financial statements.

  Section 134 requires the report of BOD to include number of meetings of the Board, Director's Responsibility Statement, statement on declaration given by independent directors, explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made, particulars of loans, guarantees or investments under Section 186, the state of the company's affairs, the amounts, if any, which it proposes to carry to any reserves, the amount, if any, which it recommends should be paid by way of dividend, material changes and commitments, if any, affecting the financial position of the company which have occurred between the end of the financial year of the company to which the financial statements relate and the date of the report etc.

  Where an application is filed by a company to the Tribunal, the government and income tax authorities are allowed to make representations.

  **For a company with the financial year ended 31st March 2016, three preceding financial years would be financial years ended 31st March 2015, 31st March 2014 and 31st March 2013.*

  **Where the company previously presented financials for a nine month period ended 31st March 2016 or fifteen month period ended 30th June 2016, three preceding financial years will include the FINANCIAL STATEMENTS pertaining to the above periods and not the periods from 1st April to 31st March.*

Section 129 relates to compliance with Accounting Standards notified u/s 133, form of financial statements for different classes of companies as per Schedule III and providing true and fair view of the state of affairs of the companies for standalone as well as consolidated financial statements.

Current Scenario

Situations	Before adoption by the shareholders in the AGM (Financial Statements are not issued to third parties)	After adoption by the shareholders in the AGM (when Financial Statements are issued to third parties)
Revision/ re- opening of annual accounts u/s 131 of the 2013 Act	BOD can revise the accounts to carry out modifications such as providing new or incremental disclosures, or application of new accounting policies along with compliance of provisions of Section 129 and 134 of the 2013 Act.	The revisions must be confined to the correction in respect of which the previous financial statements or report do not comply with the provisions of Section 129 or 134 of the 2013 Act.

Situations	Before adoption by the shareholders in the AGM (Financial Statements are not issued to third parties)	After adoption by the shareholders in the AGM (when Financial Statements are issued to third parties)
Impact on auditor's report as per SA 560	Auditor's report (AR) shall be amended and include the following: 1) An additional date restricted to that amendment or 2) An Emphasis of matter paragraph (EOM) or Other matter paragraph (OM) that conveys that auditor's procedures on subsequent events are restricted solely to amendment of the financial statements and add reference to relevant note** to the financial statements.	Auditor's report shall be amended and include the following: 1) An EOM or OM referring to a note** to the financial statements that more extensively discusses the reason for amendment of the previously issued financial statements and the earlier report provided by the auditor.

**There are various factors which investors shall consider when assessing an amendment in accounts. These include:

- The cause and significance of the error
- The likelihood of its reoccurrence
- The preventive measures including consideration of internal controls, the company is employing to prevent such an error from happening again

Procedural Requirements

MCA enforced National Company Law Tribunal Rules, 2016 (NCLT rules) and National Company Law Appellate Tribunal Rules, 2016 (NCLAT rules) from 22nd July 2016. Rule 77 of the NCLT rules prescribes the procedural requirements for application of Section 131 of the 2013 Act.

Rule 77 of the 'NCLT rules' states that where it appears to the directors of a company that the Financial Statements or the report of the Board do not comply with the provisions of Section 129 or Section 134 of the 2013 Act, they can apply for voluntary revision of the financials and Board's report.

Rule 77 of the 'NCLT rules' states that where it appears to the directors of a company that the Financial Statements or the report of the Board do not comply with the provisions of Section 129 or Section 134 of the 2013 Act, they can apply for voluntary revision of the financials and Board's report.

Procedure for voluntary restatement of Financial Statements or report of the Board under Section 131 of the 2013 Act is as follows:

- The application shall be filed in Form No. NCLT-I within fourteen days of the decision taken by the Board in case of voluntary revision by company. The application shall mention the following particulars:
  - the financial year to which such accounts relate,
  - the name and contact details of MD, CFO, CS, and officer of the company responsible for making and maintaining such books of accounts and Financial Statements,
  - name and contact details of the auditor or any former auditor who audited such accounts,
  - copy of the Board resolution passed by the Board of Directors,
  - grounds for seeking revision of Financial Statements or Board's report.

  Such application shall be accompanied with audited Financial Statements, copies of memorandum and articles of association, documents in proof of the name and contact details of the auditor or any former auditor who audited such accounts, copy of board resolution passed by the Board of Directors, affidavit verifying the petition, bank draft evidencing payment of application fee of ₹5000, memorandum of appearance with copy of the Board's Resolution or executed Vakalatnama or any other relevant document.
- The company shall, at least fourteen days before the date of hearing, advertise the application.
- The Tribunal shall hear the auditor and any other person as the Tribunal may deem fit and pass appropriate order on the matter. Also, the Tribunal shall give notice to the Central Government and Income tax authorities before passing any order under this section.

Management and TCWG are usually the first ones to identify a misstatement. Errors are also identified by auditors and sometimes by regulatory bodies. In either case, the responsibility of revising the financial statements is of the company.

- The certified copy of the order of the Tribunal shall be further filed with the Registrar of Companies within 30 days of receipt of certified copy.
- On receipt of approval from the Tribunal, a general meeting may be called in which the revised Financial Statements, statement of directors and statement of auditors shall be put up for consideration. Also, notice of such general meeting along with reasons for change in financial statements may be published in newspaper in English and in vernacular language.
- The approved revised Financial Statements along with the statement of auditors or revised report of the Board shall be filed with the Registrar of Companies within thirty days of the date of approval by the general meeting.
- However, revised Financial Statements or report shall not be prepared or filed more than once in a financial year. Also, the detailed reasons for revision of such Financial Statements or report shall also be disclosed in the Board's report in the relevant financial year in which such revision is being made.

Financial Reporting Related Responsibilities

BOD are responsible for the preparation of financial statements that give a true and fair view of the financial positions, financial performance and cash flows of the company. Statutory auditors provide an opinion on such financial statements by obtaining reasonable assurance about whether the financial statements are free from material misstatements, whether intentional or not. It is the responsibility of those charged with governance (TCWG) including audit committees to oversee the management's and auditor's work in financial reporting process.

Hence, management and TCWG are usually the first ones to identify a misstatement. Errors are also identified by auditors and sometimes by regulatory bodies. In either case, the responsibility of revising the financial statements is of the company.

Restatement of Financial Statements

Restatement can be defined as a revision of a previously issued financial statement to correct an error. Materiality is an important factor for determining whether a prior period error will result in a restatement. In many cases, revision of standalone financial statements may trigger the revision/re-opening of consolidated financial statements as well. There are chances that the errors identified in the financial statements of subsidiary entities may also exist in the financial statements of the holding company, fellow subsidiaries or joint ventures/associates. Hence, management and auditors of such entities should also be informed about the revisions being made in the financial statements as and when necessary.

Restatement and Internal Financial Controls over Financial Reporting

When an error is material to prior period financial statements, a company should restate previously issued financial statements and correct the error. Such restatements may result from one or more material weakness in internal control. This indicates that the auditor's report on the Internal Financial Controls under clause (i) of sub-Section 3 of Section 143 of the 2013 Act may be required to be revised as well in case the material weakness or deficiency pertains to an earlier year.

Revision of Comparative Information as per Indian Accounting Standards (Ind AS)

Section 133 of the 2013 Act prescribes the Indian Accounting Standards which are applicable to

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companies in accordance with the roadmap issued by the MCA.

Ind AS 8 on 'Accounting Policies, Changes in Accounting Estimates and Errors' states that an entity shall correct material prior period errors retrospectively in the financial statements approved for issue. Restatements shall be done as follows:

(a) Restating the comparative amounts for the prior period(s) presented in which the error occurred; or

(b) If the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

For example:

Management of ABC LTD, while preparing financial statements of the company for the period ended 31st March 2017, noticed that they had not provided for depreciation in last year's financial statements in respect of an office building acquired in the preceding year.

Following are extracts of ABC LTD's financial statements before restatement:

Balance sheet as at 31st March 2017		
	2017 (crores)	**2016 (crores)**
Fixed assets		
Cost	50	50
Accumulated depreciation	(10)	(8)
	40	**42**

Statement of profit and loss for the year ended 31st March 2017		
	2017 (crores)	**2016 (crores)**
Depreciation	2	1

Statement of changes in equity for the year ended 31st March 2017		
	2017 (crores)	**2016 (crores)**
Retained earnings		
Opening reserves	40	30
Net profit	30	20
Dividend	(10)	(10)
Closing reserve	**60**	**40**

Accounting Treatment

Omission of depreciation of office building in the previous year's financial statements represents a *prior period accounting error* which must be accounted for by restating the corresponding figures in the financial statements.

Management estimates that depreciation charge for the year 2016 was under booked by INR 1 crore.

Financial statement extracts of ABC LTD would appear as follows after the retrospective correction of the prior period accounting error.

Following are extracts of ABC LTD's financial statements after restatement as per Ind AS 8:

Balance sheet as at 31st March 2017		
	2017 (crores)	**2016 (crores)**
Fixed assets		
Cost	50	50
Accumulated Depreciation	(11)	(9)
	39	**41**

Statement of Profit and Loss for the year ended 31st March 2017		
	2017 (crores)	**2016 (crores)**
Depreciation	2	2

Statement of changes in equity for the year ended 31st March 2017		
	2017 (crores)	**2016 (crores)**
Retained earnings		
Opening reserves	39	30
Net profit	30	19
Dividend	(10)	(10)
Closing reserve	**59**	**39**

The restatement of comparatives under Ind AS 8 may be different when compared to revision of financial statements under the provisions of the 2013 Act. In certain jurisdictions, when an error is material to prior period financial statements, a company is required to restate previously issued financial statements and correct the error. If an error is immaterial to the prior period financial statements and fixing it in the current period financial statements would not materially misstate the current period, the

error would be corrected in the current period financial statements.

As per Accounting Standard (AS) 5 on 'Net Profit or Loss for the period, prior period items and changes in accounting policies', notified under Companies (Accounting Standards) Rules, 2006, comparative amounts disclosed in the current year's financial statements cannot be revised to correct the misstatement of prior periods. Any changes in the previous years' figures are required to be presented as prior period items in the financial statements with a reference to Notes containing information about such correction of error.

Continuing with the above example, the accounting treatment will be as below under AS 5:

Omission of depreciation of office building in the previous year's financial statements represents a *prior period accounting error* and shall be presented as prior period item.

Management estimates that depreciation charge for the year 2016 was under booked by 1 crore. Following are extracts of financial statements of ABC Ltd. after adjustment of prior period error as per AS 5:

Balance sheet as at 31st March 2017		
	2017 (crores)	**2016 (crores)**
Fixed assets		
Cost	50	50
Accumulated depreciation	(11)	(8)
	39	**42**

Statement of Profit and Loss for the year ended 31st March 2017		
	2017 (crores)	**2016 (crores)**
Depreciation	2	1
Prior period item	1	-

Impact

The 2013 Act, now provides an enabling legal framework for SEBI or any other regulatory authorities to apply for restatement of a company's financial statements under Section 130 of the 2013 Act, if they believe that the accounts were prepared in a fraudulent manner, on the basis of qualifications filed along with financial results. There is no time limit for restatement under Section 130 of the 2013 Act, due to which, the impact could be significant if the order is passed for a period long ago. Also, the companies would need to consider filing a revised income tax return based on the restated financial statements.

By providing clarity to companies about procedures to be followed in case of revision of the financial statements, these new provisions and rules shall induce the companies to act on issues flagged by the auditors with adequate safeguards and to provide the users with clear understanding of financial statements.

Restatements have generally been viewed negatively as these reflect inaccurate financial reporting in the past. There has been adverse impact on the stock prices due to restatements several times. Hence, the changes introduced shall promote the corporates to build robust internal processes and be more careful in providing financial information to the stakeholders.

Annexure

List of circulars/guidance issued related to revision of financial statements, prior to introduction of Companies Act, 2013:

In 1977	The Department of Corporate Affairs, now Ministry of Corporate Affairs (MCA) opined that a company could not reopen and revise its accounts after their adoption at the Annual General Meeting (AGM).
In 1979	ICAI issued 'Guidance Note on Auditor's Report on Revised Accounts of Companies before Circulation to Shareholders' stating that amended accounts are to be re-approved by the Boards of the Companies and statutory auditors are requested to make a report once again on the amended accounts.
In 1983	ICAI issued 'Guidance Note on Revision/Rectification of Financial Statements' deciding that the reopening or rectification of accounts after they have been adopted at the AGM should not be permitted under any circumstances.

In 1987	In partial modification of its aforesaid view, the Department clarified that a company could reopen and revise its accounts even after their adoption in the AGM in order to comply with technical requirements of taxation laws. (ICAI had issued a note on similar lines in 1985).
In 2003	ICAI issued 'Guidance Note on Revision of the Audit Report'.
	MCA issued a circular to clarify that a company could reopen or revise its accounts after the FS have been approved in AGM only in order to comply with technical requirements of any law to achieve the object of exhibiting true and fair view. The revised annual accounts were then required to be adopted either in the extraordinary general meeting or in the subsequent annual general meeting and filed with the Registrar of Companies.
In 2009	ICAI issued SA 560, applicable for audits of financial statements for periods beginning on or after April 1, 2009, providing guidance to auditors in situations when some material facts become known to the auditor, which could have altered the auditor's report, before the date the FS were issued as well as after the date the FS have been issued.
	Following guidance notes withdrawn: • Guidance Note on Revision of the Audit Report withdrawn. • Guidance Note on Revision/Rectification of Financial Statements. • Guidance Note on Auditor's Report on Revised Accounts of Companies before Circulation to Shareholders withdrawn.
In 2010	MCA issued circular stating that a company cannot lay more than one set of annual accounts for a particular financial year unless it has reopened/revised such annual accounts after their adoption in the AGM on the grounds specified in the circular issued in 2003.

If it doesn't challenge you, it won't change you. - Anonymous