Relationship between Retrospective Restatement and Reopening (Revision) of Financial Statements

Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors* (Ind AS 8) defines Retrospective Restatement (Restatement) as "correcting the recognition, measurement and disclosure of amounts of elements of financial statements as if a **prior period error** had never occurred" (emphasis supplied).

Ind AS 8 defines Prior Period Errors as

"Omissions from, and misstatements in, the entity's financial statements of one or more prior periods arising from a failure to use, or misuse of, reliable financial information that:

a) was available when financial statements for those periods were approved for issue; and
b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights and misinterpretation of facts, and fraud".

Restatement requires the correction of material prior period errors retrospectively in the first set of financial statements approved for issue after their discovery by:

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 balance of assets, liabilities and equity for the earliest period presented.

Ind AS 1, *Presentation of Financial Statements* (Ind AS 1) also requires a presentation of a third balance sheet as at the beginning of the preceding period if the restatement has a material effect on the information in the balance sheet at the beginning of the preceding period.

Accounting Standards included in the Companies (Accounting Standards) Rules, 2006 (AS) do not require any retrospective restatement of financial statements on discovery of a prior period error.

AS 5, *Net Profit or Loss for the Period, Prior period Items and Changes in Accounting Policies* (AS 5) defines prior period items as "items of income or expense which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods".

AS 5 does not require any retrospective restatement of financial statements on discovery of prior period items but requires such items to be disclosed in the statement of profit or loss of the current financial period.

Hence, the concept of restatement of financial statements is applicable to only those companies which prepare financial statements in compliance with Indian Accounting Standards (Ind AS).

Now coming to reopening of financial statements.

Reopening of financial statements is not covered in any accounting standards whether AS or Ind AS.

Reopening (revision) of financial statements can be defined as revision of the financial statements of a company after they have already been adopted by the shareholders.

There was no provision for such reopening or revision of financial statements under the Companies Act, 1956. The Institute of Chartered Accountants of India (ICAI) required a Chartered Accountant who was an auditor of the company which revised its already adopted financial statements to qualify the audit report in this aspect quantifying all the amendments made to revised financial statements.

However, there are specific provisions regarding reopening of financial statements in the Companies Act, 2013 (Act).

Section 130 of the Act prescribes that a company shall not re-open its books of account or recast its financial statements unless an application has been made by the Central Government or a regulatory body or authority to a court of competent jurisdiction or to the National Company Law Tribunal (NCLT) and such appropriate order is passed by such court or NCLT. It may be noted that an application under this section can only be made in case:

a) The relevant earlier accounts were prepared in a fraudulent manner; or
b) The affairs of the company were mismanaged during the relevant period, casting a doubt on the reliability of financial statements.

Section 131 of the Act allows the Board of Directors of a company to prepare revised financial statements or revised Board report in respect of any of the three preceding years financial years after obtaining the approval of NCLT after making an application. The section allows a company to revise its financial statements only if it appears to the directors that

a) the financial statements of the Company; or
b) the report of the Board

do not comply with section 129 or section 134 of the Act.

Section 129 of the Act states that the financial statements shall be prepared in compliance with the accounting standards prescribed under section 133 of the Act. Section 134 prescribes the manner of approval and authentication of the financial statements and the Board report and the contents of the Board report.

In my opinion, a reopening and revision of earlier years' financial statements would be required in cases where the discovery of errors (including fraud) and/ or other facts and circumstances that come to light, lead to a conclusion that the earlier years' financial statements may not be reflecting a true and fair view of the financial position and financial performance of the company in those years.

An example of reopening and revision of financial statements is that of CG Power and Industrial Solutions Limited (CGPISL), which upon discovering certain fraudulent financial transactions in earlier years first restated the comparative numbers in its financial statements for the year ended 31 March 2019 and thereafter applied to NCLT under section 131 of the Act to allow it to reopen and revise its financial statements of earlier years. Also, Ministry of Corporate Affairs (MCA), filed an application, in November 2019, to reopen and revise the financial statements of the Company under section 130 of the Act.

Based on news reports, NCLT approved MCA's application to reopen and revise CGPISL's financial statements in March 2020.

Prior to this, NCLT had allowed, in January 2019, to reopen financial statements for past five years of IL&FS and its subsidiaries.

A retrospective restatement of financial statements may lead to reopening and revision of earlier years' financial statements. However, a reopening and revision of earlier years' financial statements will not lead to restatement of financial statements since the revised financial statements of previous year will form the comparatives to be included in current year's financial statements.

Another difference between a retrospective restatement of financial statements and a reopening and revision of earlier years' financial statements is that while restatement is permitted only under Ind AS, the provisions of the Act regarding reopening and revision of financial statements apply to all financial statements whether prepared in compliance with Ind AS or in compliance with AS.

Also, while a restatement of the financial statements is in the Company's own hands, a reopening and revision of financial statements requires approval of NCLT. As noted from the example of CGPISL above, the process of obtaining such approval may be time consuming.

The relationship between restatement of financial statements and reopening of financial statements can be explained with the help of the following two examples.

EXAMPLE 1

A Ltd.'s financial year ends on 31 March.

A Ltd had income from providing services in a foreign country, say USA, for a number of years.

Based on advice received by A Ltd., that its provision of services in the USA amounts to having a Permanent Establishment in the USA and that it is liable to pay tax in USA on its income earned in the USA, A Ltd. started making a provision for income tax payable in USA and interest thereon from year ended 31 March 2016 onwards.

The interest payable on income tax payable in USA was also included in the income tax expense and the income tax provision made.

During the year ended 31 March 2020, A Ltd. paid the income tax payable in USA and interest thereon upto the date of payment of the tax.

Based on the provisions of the Indian income tax law, A Ltd. has determined that the interest on income tax paid in USA can be claimed by it as a deduction (on payment basis) in arriving at taxable income in India, and accordingly, it has computed its current tax expense and current tax provision for the year ended 31 March 2020 after considering the interest paid.

There has been no change in the Indian income tax law provisions in this regard in the last 10 years.

A Ltd. had a net worth in excess of Rs. 250 crores as of 31 March 2018 and accordingly it prepared its first Ind AS compliant financial statements for the year ended 31 March 2019 with the transition date of 1 April 2017.

For simplicity's sake, it is assumed that there is no GAAP difference between AS and Ind AS so far as A Ltd. is concerned. Also, that the Indian income tax rate has been considered at a constant 30% for all the years presented. Under India - USA double tax avoidance treaty, credit for income tax paid in USA can be availed while paying Indian income tax.

Relevant extracts of the financial statements of A Ltd. for various years are as follows:

A Ltd. Extracts of financial Statements	2020 Draft Ind AS Rs. in crores	2019 Audited Ind AS Rs. in crores	2018 Audited Ind AS Rs. in crores	2018 Audited AS Rs. in crores	2017 Audited AS Rs. in crores	2016 Audited AS Rs. in crores
Balance Sheet						
Share Capital	1,000	1,000	1,000	1,000	1,000	1,000
Retained Earnings	5,172	4,370	3,593	3,593	2,981	2,500
Current Liabilities	1,400	1,300	1,200	1,200	1,100	1,000
Income Tax Provision						
- India	268	586	469	469	375	-
- USA Income Tax	3,662	10,648	7,719	7,719	5,375	3,500
- Interest on USA Income Tax	-	1,180	794	794	525	350
	3,930	12,414	8,981	8,981	6,275	3,850
Deferred Tax Asset	180	160	140	140	120	100
Statement of Profit and Loss						
Revenues	48,828	39,063	31,250	31,250	25,000	20,000
Interest Expense	1,221	977	781	781	625	500
Profit before Tax	14,648	11,719	9,375	9,375	7,500	6,000
Current Tax expense						
- India	268	586	469	469	375	-
- USA Income Tax	3,662	2,930	2,344	2,344	1,875	3,500
- Interest on USA Income Tax	100	386	269	269	175	350
Deferred Tax	-20	-20	-20	-20	-20	-20
Total Tax Expense	4,010	3,882	3,061	3,061	2,405	3,830
Profit After Tax	10,638	7,837	6,314	6,314	5,095	2,170

It may be noted that under both AS 22, *Accounting for Taxes on Income* (AS 22) and Ind AS 12, *Income Taxes* (Ind AS 12) define income tax as tax based on taxable profits. Accordingly, interest paid/ payable on delayed payment of income tax does not meet the definition of income tax. Instead, such interest is in the nature of a financing charge and accordingly, should be disclosed as a part of interest expense.

Accordingly, interest on USA income tax should be reclassified as interest expense for the year ended 31 March 2020. Also, the comparative figures for the year ended 31 March 2019 should be restated to show such interest as part of interest expense. Since, in earlier years, such interest has already been considered as a deduction to arrive at profit after tax, there is no adjustment required in retained earnings as of 1 April 2018.

However, since such interest is allowed as a deduction for computing taxable income in India on payment basis, creation of a provision for such interest without actual payment is a deductible temporary difference (under Ind AS 12) and timing difference (under AS 22), and accordingly, deferred tax asset should have been created on provision of such interest.

Hence, comparatives for the year ended 31 March 2019, included in the financial statements for the year ended 31 March 2020, should be restated to include deferred tax assets in respect of provision made during the year. Further, opening retained earnings as of 1 April 2018 should be adjusted for deferred tax adjustment and creation of deferred tax asset on the amount of provision existing as of 31 March 2018.

Based on the above, the restated financial statements of A Ltd. are as follows:

Restated Financial Statements **A Ltd. Extracts of financial Statements**	**2020** **Audited** **Ind AS** **Rs. in crores**	**2019** **Audited** **Ind AS** **Rs. in crores**	**2018** **Audited** **Ind AS** **Rs. in crores**	**2018** **Audited** **AS** **Rs. in crores**	**2017** **Audited** **AS** **Rs. in crores**	**2016** **Audited** **AS** **Rs. in crores**
Balance Sheet						
Share Capital	1,000	1,000	1,000	1,000	1,000	1,000
Retained Earnings	5,172	4,370	3,593	3,593	2,981	2,500
- Restatement Adjustment	-	354	238	238	158	105
Retained Earnings (Restated)	5,172	4,723	3,831	3,831	3,139	2,605
% change	0.0%	8.1%	6.6%	6.6%	5.3%	4.2%
Current Liabilities						
-Current Liabilities	1,400	1,300	1,200	1,200	1,100	1,000
- Interest on USA Income Tax (Restated)	-	1,180	794	794	525	350
	1,400	2,480	1,994	1,994	1,625	1,350
% change	0.0%	90.7%	66.1%	66.1%	47.7%	35.0%
Income Tax Provision						
- India	268	586	469	469	375	-
- USA Income Tax	3,662	10,648	7,719	7,719	5,375	3,500
Income Tax Provision (Restated)	3,930	11,234	8,188	8,188	5,750	3,500
% change	0.0%	10.5%	9.7%	9.7%	9.1%	10.0%
Deferred Tax Asset	180	160	140	140	120	100
- Restatement Adjustment	-	354	238	238	158	105
Deferred Tax Asset (Restated)	180	514	378	378	278	205
% change	0.0%	221.2%	170.1%	170.1%	131.3%	105.0%
Statement of Profit and Loss						
Revenues	48,828	39,063	31,250	31,250	25,000	20,000
Interest Expense	1,221	977	781	781	625	500
- Restatement Adjustment	100	386	269	269	175	350
Interest Expense (Restated)	1,321	1,363	1,050	1,050	800	850
% change	8.2%	39.5%	34.4%	34.4%	28.0%	70.0%
Profit before Tax (Restated)	14,548	11,333	9,106	9,106	7,325	5,650
% change	0.7%	3.3%	2.9%	2.9%	2.3%	5.8%
Current Tax expense						
- India	268	586	469	469	375	-
- USA Income Tax	3,662	2,930	2,344	2,344	1,875	3,500
Deferred Tax	-20	-20	-20	-20	-20	-20
- Restatement Adjustment	354	-116	-81	-81	-53	-105
Deferred Tax (restated)	334	-136	-101	-101	-73	-125
Total Tax Expense (Restated)	4,264	3,380	2,712	2,712	2,178	3,375
% change	-6.3%	12.9%	11.4%	11.4%	9.5%	11.9%
Profit After Tax (Restated)	10,285	7,953	6,394	6,394	5,148	2,275
% change	3.3%	-1.5%	-1.3%	-1.3%	-1.0%	-4.8%

Considering that the change in amount of total current liabilities, income tax provision, deferred tax assets, interest expense and total income tax expense is material for all the earlier years, apart from restatement of comparatives in the financial statements for the year ended 31 March 2020, A Ltd. should assess whether the changes are material enough for it to reopen and revise its financial statements of preceding three years following the provisions of section 131 of the Act.

EXAMPLE 2

B Ltd.'s financial year ends on 31 March. B Ltd. prepares its financial statements following Ind AS. The transition date to Ind AS was 1 April 2016.

C Ltd. amalgamated with B Ltd. C Ltd. is not under common control with B Ltd. The appointed date of amalgamation as per the scheme of arrangement filed with NCLT is 1 April 2017. The approval of NCLT to the scheme of arrangement was received in April 2020 and the scheme became effective as of 1 May 2020.

For each of the financial years, the assets, liabilities, income, and expenses of C Ltd. are roughly half those of B Ltd.

B Ltd.is yet to issue its financial statements for the year ended 31 March 2020.

Ind AS 103, *Business Combinations* (Ind AS 103) provides that a business combination (including amalgamations) should be accounted for on the acquisition date which is the date on which the acquirer obtains control of the acquiree. Accordingly, in case of an amalgamation, the acquisition date is the date on which the scheme of arrangement became effective since before that date both the amalgamating and the amalgamated companies were independent companies. However, as per a circular dated 21 August 2019 issued by the Ministry of Corporate Affairs (MCA), in case of a scheme under the Companies Act, 2013, the Appointed Date is deemed to be the acquisition date/ date of transfer of control under Ind AS 103.

Accordingly, B Ltd. is required to account for the amalgamation of C Ltd. with itself on and from 1 April 2017.

While, a retrospective acquisition date is not a prior period error, I believe that B Ltd. is required to restate the comparative figures in the financial statements for the year ended 31 March 2020 and also the opening balance of retained earnings and assets and liabilities as of 1 April 2018 to reflect the business combination from 1 April 2017. Considering that the restatements are material, B Ltd. is also required to present a third balance sheet as of 1 April 2018 (restated) as a part of its financial statement for the year ended 31 March 2020. It may be noted that Ind AS 103 does not specifically require the third balance sheet.

Further, considering that the date of acquisition as per Ind AS 103 read with MCA's circular is 1 April 2017, in my opinion, B Ltd. should also reopen and revise its financial statements for the years ended 31 March 2018 and 31 March 2019 following the provisions of section 131 of the Act.

Alternatively, considering the time period involved in obtaining approval of NCLT, B Ltd. may first reopen and revise its financial statements for the years ended 31 March 2018 and 31 March 2019 following the provisions of section 131 of the Act and then, prepare the financial statements for the year ended 31 March 2020 which will include comparatives based on the revised financial statements for the year ended 31 March 2019.

I hope, I have been able to explain the relationship between retrospective restatement and reopening/ revision of financial statements.