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NFRA Inspection *Insights*



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Introduction









The National Financial Reporting Authority (NFRA) conducts periodic inspections of audit firms responsible for auditing listed companies and other public interest entities in India. These inspections review whether audit engagements were performed in accordance with applicable auditing standards and whether sufficient and appropriate audit evidence was obtained to support the audit opinion.

In March 2026, NFRA released multiple Inspection Reports forming part of its 2024 inspection cycle. These reports covered both firm-wide quality controls and selected audit engagement files across different industries.

A review of these inspection observations shows that certain accounting and financial reporting areas continue to appear repeatedly across engagements. In many cases, the issue was not the absence of accounting guidance, but the difficulty of applying that guidance consistently in areas involving significant judgement, estimates, operational complexity or management assumptions.

This article discusses some of the key areas that featured prominently across the inspection reports released during the 2024 inspection cycle, including:

 Revenue Recognition (Ind AS 115)	 Goodwill & Intangibles (Ind AS 36 & 38)	 Inventory (Ind AS 2)	 Financial Instruments / ECL (Ind AS 109)	 Related Party (Ind AS 24)	 Going Concern (Ind AS 1)
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The purpose of this article is not to reproduce inspection findings mechanically, but to explain why these areas continue to be challenging in practice and how the underlying accounting requirements apply in real business situations.

Revenue Recognition



Revenue is one of the most sensitive areas in financial reporting. It directly affects profitability, investor expectations, management performance, and sometimes even loan covenants. Because of that, mistakes in revenue recognition tend to attract close attention from regulators and auditors. NFRA inspection findings show that revenue continues to be one of the most commonly challenged areas across audit engagements. The reasons are usually practical rather than theoretical. Companies may have complicated contracts, changing commercial terms, milestone-based billing, rebates, or delivery arrangements spread across different periods. In these situations, applying the accounting standard consistently becomes difficult.

At the center of most issues is a simple question: when has the company actually earned the revenue?



Understanding the Objective of Ind AS 115

Revenue recognition under Ind AS is governed by Ind AS 115, Revenue from Contracts with Customers. The standard introduced a common framework that applies across industries instead of having separate rules for different sectors.

The idea behind the standard is straightforward. Revenue should reflect the transfer of goods or services to a customer in an amount the company realistically expects to receive.

To apply this, companies work through five broad steps:



In practice, the last step is usually where the biggest judgement comes in.

A company needs to decide whether revenue should be recognized gradually over the contract period or at a specific point when control passes to the customer.

That assessment affects the entire accounting outcome.

For example, a company building infrastructure may recognize revenue over time if the customer receives the benefit as construction progresses. A manufacturer selling equipment may recognize revenue only once delivery is completed and control transfers to the buyer.

If this judgement is wrong, the impact does not stay limited to one reporting period. It can affect revenue recognition across the full life of the contract.

Where Companies Commonly Struggle



Over-Time vs Point-in-Time Recognition

This is one of the most common areas where inspection findings arise.

Some companies recognize revenue over time simply because work is ongoing. But under Ind AS 115, ongoing work alone is not enough. The company must show that the customer is receiving the benefit as the work is performed or that the company has a clear right to payment for work completed up to that point.

In practice, companies sometimes rely heavily on internal progress reports or management estimates without properly evaluating the actual contract terms.

The opposite issue also happens. Revenue gets postponed until final delivery even though the customer has effectively been receiving and consuming the benefit throughout the arrangement.

Both situations create the same problem. It may result in accounting that does not fully reflect the economic reality of the contract.



Cut-Off Issues

Cut-off errors are another recurring problem.

Revenue must be recognized in the correct reporting period. That sounds simple, but in practice it often becomes messy around quarter-end or year-end, especially where goods are in transit or customer acceptance is pending.

The key question is whether control has actually passed to the customer by the reporting date. For goods-based businesses, this usually depends on shipping and delivery terms. In some contracts, control passes once goods leave the seller's warehouse. In others, it passes only when the customer receives the goods at the final destination.

Challenges often occur when entries are recorded before sufficient supporting evidence is available. For example:

- invoices may be raised before dispatch;
- delivery confirmations may still be pending; or
- customer acceptance may not yet be received.

These timing differences can materially affect reported revenue.

Inspection findings often identify cases where companies relied mainly on internal records without sufficient third-party evidence such as delivery confirmations, signed acceptance documents, or transport records.

The risk becomes even higher near the reporting date because there is pressure to close transactions before the period ends.





Rebates, Discounts, and Variable Consideration



Another area where companies struggle is variable consideration.

This includes rebates, volume discounts, price concessions, penalties, refunds, and sales returns.

Under Ind AS 115, companies cannot wait until the uncertainty is fully resolved before considering these items. They need to estimate the expected impact upfront and adjust revenue accordingly. Inspection experience indicates the process is often not fully effective.

Rebate arrangements may not be tracked properly. Informal pricing concessions may be agreed through emails or commercial discussions without being reflected in the accounting records. Return obligations may only be recognized once products are physically returned rather than estimated in advance. The issue is usually not that companies apply the wrong formula. The problem is that the estimation process itself is incomplete.



Contract Modifications

Long-term contracts frequently change after they begin.

The scope may increase, pricing may change, timelines may be revised or additional services may be added. Every such change requires an accounting assessment. Companies need to determine whether the modification should be treated:

- as a separate new contract; or
- as part of the existing arrangement.

That assessment affects how future revenue is recognized.

A common problem is that modifications are reviewed only at year-end instead of when they occur. In some cases, multiple small changes are treated individually even though together they significantly alter the economics of the original contract. Over time, these missed assessments can distort revenue recognition across several reporting periods.



Illustrative Scenario: Infrastructure Company Using Milestone Billing

A highway construction company is working on a long-term government contract. At the year-end of 31 March, it recognizes revenue of ₹480 crore based on an internal project completion certificate prepared by the engineering team.

However, the formal acceptance letter from the customer is received only on 18 April.

Accounting question is whether the company had actually transferred control by 31 March.

If customer acceptance is only an administrative step, the revenue may still be appropriate. But if the contract gives the customer a genuine right to review and reject the work before acceptance, then recognizing the full revenue before approval may be premature.

In that case, the company may need to recognize a contract asset instead of recognizing full revenue immediately.

The important point is that internal project confirmation alone may not always be enough evidence. The accounting conclusion must align with the actual contractual rights and obligations.



Good Practice



Strong revenue accounting usually comes down to discipline in a few key areas.

Companies that handle this area well typically:

- document their revenue conclusions at the start of the contract;
- clearly assess whether revenue should be recognized over time or at a point in time;
- update estimates regularly instead of relying on old budgets;
- maintain proper support for rebates and discounts; and
- perform detailed cut-off reviews around reporting dates.

Equally important, they reassess contracts whenever commercial terms change rather than waiting until year-end.

In most inspection findings, the issue is not the absence of accounting guidance. The deficiency arises from inadequate documentation, incomplete evaluation, or reliance on assumptions that lacked proper challenge.





Goodwill and intangible assets are some of the most judgement-heavy areas in financial reporting. Unlike cash, inventory, or fixed assets, their value is not directly visible or easily measurable. It depends on expectations regarding future growth, profitability, customer relationships, brand value, and market conditions.

That is why this area regularly appears in NFRA inspection findings. In most cases, the issue is not that companies fail to perform impairment testing. The issue is that the assumptions used in the valuation process are either too optimistic, poorly supported or not properly challenged. A valuation model may be technically sophisticated, but if the supporting assumptions lack robustness, the resulting conclusion cannot be relied upon.



Understanding the Accounting Framework

Goodwill is primarily governed by Ind AS 103, Business Combinations.

It arises when a company acquires another business for more than the fair value of its identifiable net assets. In simple terms, goodwill represents the value the buyer expects to receive from things that are difficult to separately measure, such as brand reputation, customer loyalty, skilled workforce, expected synergies, or future growth opportunities.

Once recognized, goodwill is tested for impairment under Ind AS 36, Impairment of Assets. Unlike many other assets, goodwill is not amortized every year. Instead, companies must assess at least annually whether the carrying value of goodwill can still be supported by the future cash flow expected from the business. Other intangible assets such as brands, customer relationships, software, licenses, technology and non-compete arrangements are generally accounted for under Ind AS 38, Intangible Assets.



Why This Area Becomes Difficult in Practice

Impairment testing is difficult because it depends heavily on estimates about the future.

Companies usually prepare discounted cash flow models to estimate the recoverable value of a business or cash-generating unit. These models involve assumptions about- future revenue growth, operating margins, cash flows, long-term growth rates, and discount rates.

Even though the calculations may appear sophisticated, the quality of the outcome depends entirely on whether these assumptions are realistic and properly supported.



Cash Flow Forecasts

One of the most common problems is overly optimistic forecasting. Management projections sometimes assume strong future growth even when:

- business has historically grown slowly;
- the sector is under pressure; or
- Current operating performance does not support such expectations.

For example, a mature business operating in a stable industry may project double-digit growth for several years without a clear commercial basis.

Inspection findings often identify situations where projections appear to reflect management expectations rather than objective evidence.

Forecasts should ideally be supported by historical trends, industry reports, analyst expectations, market demand and clearly identifiable business plans.

The further assumptions move away from observable evidence, the harder they become to justify.



Discount Rates

The discount rate is another important judgement area under Ind AS 36.

A lower discount rate increases the valuation, while a higher discount rate reduces it. Even small changes can materially change the impairment conclusion. In practice, companies sometimes use discount rates that are not properly linked to the actual risks of the business. In some cases, the derivation itself is not adequately documented. The issue becomes more complex because Ind AS 36 requires the use of a pre-tax discount rate. However, many valuation models are initially built using post-tax assumptions. If the conversion is not handled carefully, the final valuation may become unreliable.



Terminal Growth Rates

Another sensitive assumption is the terminal growth rate.

This reflects the long-term growth expected after the detailed forecast period ends. Since terminal value often forms a large portion of the total valuation, even a small increase in this growth rate can significantly increase the recoverable amount. Problems arise when companies use growth assumptions that exceed what the industry or broader economy can realistically sustain over the long term.

For example, a mature business operating in a low-growth industry may still assume aggressive long-term expansion without clear justification. In such cases, the valuation may avoid impairment simply because the assumptions are too favorable.



Sensitivity Analysis

Sensitivity analysis is equally important. Sometimes a valuation technically shows sufficient headroom, but the conclusion changes completely with only a minor adjustment in assumptions.

For example: a small reduction in projected growth, a slight increase in discount rate or lower operating margins may eliminate the entire surplus between recoverable value and carrying value.

Ind AS 36 specifically requires companies to disclose such sensitivities where reasonably possible changes in assumptions could materially affect the conclusion.

This helps users understand how dependent the valuation is on management assumptions.



Purchase Price Allocation After an Acquisition



Another area where inspection findings commonly arise is purchase price allocation, often referred to as PPA.

Under Ind AS 103, when a company acquires another business, it cannot simply record the entire excess purchase price as goodwill. It first needs to identify and separately value intangible assets acquired as part of the transaction. These may include customer relationships, brands, technology, licenses, order backlog, in-process research and non-compete agreements. This exercise matters because identifiable intangibles are generally amortized over time. If too much of the purchase price is allocated to goodwill instead of identifiable intangible assets, future amortization expenses may appear lower and reported profits may look stronger than they should. Inspection findings often identify cases where the purchase price allocation was incomplete, independent valuation support was missing, or management assumptions were not adequately challenged.



Illustrative Scenario:

Retail Group Performing Goodwill Impairment Testing

A retail conglomerate carries goodwill of ₹3,400 crore arising from an acquisition completed several years earlier. While preparing its annual impairment assessment under Ind AS 36, management projects revenue growth of 17% annually over the next five years, even though the sector historically grew at around 5%.

The valuation model also uses:

- a terminal growth rate that exceeds broader economic growth expectations; and
- a discount rate derived from a simplified post-tax calculation without a proper pre-tax adjustment.

Based on these assumptions, the model shows sufficient headroom and no impairment is recognized.

However, the conclusion changes significantly if:

- projected growth is reduced;
- margins soften slightly; or
- the discount rate increases modestly.

In this situation, the concern is not only whether the assumptions are aggressive. The larger concern is whether the valuation remains reliable once more balanced assumptions are applied.



Good Practice

Companies that handle this area well usually focus less on making the valuation model complex and more on making the assumptions realistic, supportable, and well documented.

Good practice generally includes:

- linking projections to historical and market evidence;
- using realistic long-term growth assumptions;
- properly documenting the derivation of discount rates;
- performing meaningful sensitivity analysis; and
- involving valuation specialists where necessary.

It is also important to revisit cash-generating units regularly, especially after restructurings, acquisitions, or operational changes. Most importantly, impairment testing should not become an exercise designed to protect an existing balance sheet value. The objective under Ind AS 36 is to genuinely assess whether the business can still support the value recorded in the financial statements.

Inventory Valuation and Existence

Inventory is one of the most operationally dependent areas in financial reporting. Unlike many accounting balances that are driven mainly by calculations or contracts, inventory depends heavily on physical processes: production, storage, movement of goods, warehouse controls, and monitoring systems. Because of this, even companies with strong finance teams can face issues if operational controls are not up to the mark.

NFRA inspection findings in this area usually fall into two broad categories:

- whether the inventory actually exists; and
- whether it is valued correctly.

Both issues can affect the financial statements.

A company may record inventory that is damaged, obsolete, missing, or stored in conditions that reduce its value significantly. In other cases, the inventory may physically exist, but the carrying value may no longer be recoverable because the expected selling price has fallen.



Understanding the Accounting Framework

Inventory accounting is governed by Ind AS 2, Inventories.

The standard requires inventory to be measured at the lower of cost, and net realizable value (NRV).

Cost includes purchase costs, conversion costs, and other costs incurred in bringing the inventory to its present location and condition.

For manufacturing entities, this also includes an allocation of production overheads.

Net realizable value refers to the estimated selling price less costs required to complete the product, and costs necessary to sell it. This means inventory cannot continue to be carried at historical cost if the company no longer expects to recover that amount through sale or use.

Ind AS 2 also requires companies to use a consistent cost formula such as:

- FIFO; or
- weighted average cost.

LIFO is not permitted under Ind AS.



Why Inventory Becomes Difficult in Practice

Physical Existence and Coverage.

The first challenge is simply knowing what inventory the company actually holds.

This becomes more difficult when inventory is spread across multiple warehouses, third-party storage facilities, consignment locations, in-transit arrangements and vendor-managed sites.

In such cases, companies may not always have direct visibility over the condition or quantity of goods stored outside their own facilities.

Inspection findings often identify situations where: physical verification procedures were incomplete, confirmations from third-party warehouses were not appropriate, or ageing and condition assessments relied heavily on operator representations.



The problem becomes extensive when the inventory is sensitive to temperature, shelf life, moisture, contamination, or specialized storage conditions.

If the company cannot reliably establish that inventory exists in usable condition, the valuation itself becomes unreliable.



Net Realizable Value (NRV)

Companies often face difficulties when performing NRV assessments.

Many companies use simple ageing-based provisioning rules. For example:

- inventory older than six months may be written down by a fixed percentage; or
- slow-moving items may automatically attract standard provisions.

While this approach is easy to apply, it may not always reflect commercial reality.

Some products naturally move slowly but still retain value. Others may move quickly but at prices below cost.

A stronger NRV assessment usually involves reviewing:

- actual selling prices;
- post-period sales;
- current market conditions;
- confirmed customer orders; and
- expected completion costs.

This becomes especially important for industries with changing technology, short product cycles, fashion risk, or volatile commodity pricing.

In such industries, inventory values can deteriorate quickly.



Overhead Absorption

Manufacturing entities also face challenges in allocating production overheads.

Under Ind AS 2, fixed production overheads should be allocated based on normal production capacity, not actual output during unusually low production periods.

This distinction matters. If a factory operates far below normal capacity, the cost of idle capacity should generally be recognized as an expense in the current period rather than being absorbed into inventory.

Otherwise, inventory values may become artificially inflated.

Inspection findings sometimes identify cases where companies continue absorbing high fixed costs into inventory despite significant underutilization of facilities. This delays recognition of operational inefficiencies and pushes costs into future periods.



Cut-Off Around Reporting Dates



Inventory cut-off is another recurring issue. Goods dispatched before year-end may still appear in inventory records. Similarly, goods received close to the reporting date may not yet be recorded properly. The accounting treatment often depends on:

- delivery terms;
- transfer of control; and
- shipping arrangements.

Where reconciliation processes are insufficient, inventory balances can be misstated simply because transactions were recorded in the wrong period.



Illustrative Scenario:

Consumer Goods Company Using Third-Party Cold Storage

A packaged food manufacturer reports inventory of ₹680 crore at year-end. Out of this:

- ₹510 crore is stored at the company's primary warehouse, and
- ₹170 crore is held across multiple third-party cold storage facilities.

The company's inventory ageing report shows no major concerns and no write-down is recorded. However, the ageing analysis is based on dispatch dates rather than actual production dates, which understates the true age of some products. The company also relies mainly on periodic self-certifications from warehouse operators instead of independent temperature monitoring systems.

Three months after the reporting date, inventory worth ₹62 crore is written off following a cold-chain failure at two facilities. At this stage, the key accounting question becomes whether the issue existed at the reporting date itself. Under Ind AS 10, Events after the Reporting Period, the write-off may require adjustment if it provides evidence of conditions that already existed before year-end. The absence of proper monitoring and verification procedures makes that assessment significantly more difficult.



Good Practice

Companies that manage inventory well usually treat it as both an operational and accounting risk area rather than only a finance process.

Good practice generally includes:

- maintaining visibility across all storage locations;
- performing regular physical verification;
- obtaining strong third-party confirmations; and
- monitoring inventory condition continuously.

For valuation, companies should support NRV assessments using actual sales data, market pricing, and product-level analysis rather than relying only on ageing percentages. Manufacturing entities should also document how normal production capacity is determined and ensure idle capacity costs are not hidden within inventory balances. Around reporting dates, strong cut-off procedures are critical. Inventory movements near year-end should be reconciled carefully to dispatch records, goods received notes, and shipping documentation. In many inspection findings, the issue is not a complex accounting interpretation but rather insufficient operational evidence supporting the inventory balance in the financial statements.



Loans and advances are often presented in financial statements as stable financial assets, but in reality, they can carry significant estimation and recoverability risk. This becomes even more important when the borrower is financially stressed, repayment timelines keep changing or the lender is relying heavily on future business performance to recover the amount. Inspections commonly point to opportunities to strengthen how companies assess credit risk and recognize impairment losses. A common pattern across inspections is that companies continue carrying loans at full value even when there are visible signs of financial difficulty at the borrower level. In many cases, the accounting conclusion relies more on management expectation than on objective financial evidence.



Understanding the Accounting Framework

Loans, advances, and other financial assets are primarily governed by Ind AS 109, Financial Instruments. One of the biggest changes introduced by Ind AS 109 was the shift from an incurred loss model to an expected credit loss (ECL) model. Under the earlier approach, companies typically recognized impairment only after a clear loss event had already occurred. Ind AS 109 requires companies to assess expected losses earlier by considering:

- historical default experience;
- current financial conditions; and
- forward-looking information.

The objective is to recognize credit deterioration before the loss fully materializes.

Understanding the Expected Credit Loss Model

Stage 1

Assets where credit risk has not increased significantly since initial recognition are classified in Stage 1. For these assets, companies recognize a 12-month expected credit loss.

Stage 2

If credit risk increases significantly, the asset moves to Stage 2. At this stage, companies must recognize lifetime expected credit losses instead of only 12-month losses. This transition is important because the provision can increase materially once an asset moves from Stage 1 to Stage 2.

Stage 3

Assets that are already credit-impaired fall into Stage 3. These assets continue to carry lifetime expected losses, and interest income is generally recognized on the net carrying amount after impairment.



Identifying Significant Increase in Credit Risk

Many companies rely too heavily on overdue status alone.

For example, they may assume that unless payments are overdue by more than 30 days, no significant increase in credit risk exists. However, Ind AS 109 requires a broader assessment. Credit quality may deteriorate even before payment defaults occur. Important indicators may include recurring operating losses, declining cash flows, Industry stress, covenant breaches, refinancing difficulties and pressure on financial ratios. Inspection findings often identify cases where these warning signs were visible but not properly considered in the staging assessment. However, Ind AS 109 requires a broader assessment. Credit quality may deteriorate even before payment defaults occur. Important indicators may include recurring operating losses, declining cash flows, Industry stress, covenant breaches, refinancing difficulties and pressure on financial ratios. Inspection findings often identify cases where these warning signs were visible but not properly considered in the staging assessment.



Forward-looking assumptions where supporting evidence is limited



Another challenge is incorporating future economic conditions into the ECL model.

Ind AS 109 requires companies to consider forward-looking information rather than relying only on past trends. This may include interest rate movements, economic slowdown, sector-specific stress, inflation and changes in commodity prices.

In practice, some ECL models become too mechanical and fail to reflect changing economic realities.

Others use assumptions that are overly optimistic and difficult to support with market evidence. The problem is usually not the existence of a model. The issue is whether the model realistically reflects the borrower's actual risk profile.



Inter-Corporate Loans

One of the most misunderstood areas involves loans to subsidiaries, associates, or group entities.

Companies sometimes assume that because the borrower is a related party, impairment assessment becomes less important.

That is not the case. Under Ind AS 109, these loans are still financial assets and must be assessed for expected credit losses.

This becomes especially important when the subsidiary is loss-making, repayment timelines keep extending, interest payments are rolled over, or the borrower has negative net worth. In such situations, management intent alone is not enough support for a nil impairment conclusion. Inspection findings often point out that companies rely heavily on-board representations or future business expectations without performing detailed financial analysis of the borrower's repayment capacity.



Loan Modifications and Restructuring

Another issue arises when loan terms are repeatedly modified or extended.

Changes in repayment schedules, interest rates, or tenure may require a reassessment under Ind AS 109.

In some cases, the modification may be substantial enough to require derecognition of the original financial asset and recognition of a new one.

However, in practice, companies sometimes treat repeated restructurings as routine administrative extensions without evaluating the accounting impact properly.



Illustrative Scenario: Holding Company Funding Loss-Making Subsidiaries

A listed holding company has extended loans of ₹1,250 crore to three wholly owned subsidiaries. All three subsidiaries have reported operating losses for multiple years. Two of them have negative net worth, and interest payments have not been received in cash for a prolonged period. Instead, the unpaid interest is being rolled over into the outstanding balance. Despite these indicators, the holding company records no expected credit loss provision.

Management supports the conclusion by stating that:

- the subsidiaries have strong long-term business potential; and
- the group intends to continue supporting them financially.

However, no detailed cash flow projections or repayment analysis have been prepared. Under Ind AS 109, the company would need to assess;

- whether credit risk has increased significantly,
- whether lifetime expected losses should be recognized; and
- whether the repeated interest rollovers amount to a loan modification requiring further accounting assessment.

The key issue is not whether recovery is impossible. The issue is whether the current carrying value is still fully supportable based on objective evidence.



Illustrative Scenario: Loan Recoverability Assessment under Ind AS 109

An inspection report highlighted a similar issue involving loans extended to a group entity. In this case, Company A extended a significant loan to its wholly owned subsidiary and also held an equity investment of ₹306 crore in the same entity. During the year, the investment was written down by ₹15 crore as a result of the subsidiary's stressed financial performance. However, while investment impairment was recognized, the loan was assessed together with the investment under Ind AS 36, Impairment of Assets. The audit file reportedly did not contain adequate documentation supporting the recoverability assessment of the loan.

NFRA observed that this treatment was technically incorrect because loans are financial assets excluded from the scope of Ind AS 36. Instead, they are required to be assessed under the Expected Credit Loss model prescribed in Ind AS 109, Financial Instruments. NFRA referred to:

- Para 5.5.1 of Ind AS 109, which requires recognition of a loss allowance;
- Para 5.5.3, which requires assessment of whether credit risk has increased significantly at each reporting date; and
- Para 5.5.9, which requires recognition of lifetime expected credit losses once such deterioration exists.

NFRA also noted that the impairment already recognized on the equity investment was itself a strong indicator that the recoverability of the loan required further evaluation. Despite this, the inspection reportedly identified:

- no assessment of significant increase in credit risk (SICR);
- no ECL estimation;
- no detailed cash flow review; and
- no documented recoverability assessment.

NFRA concluded that sufficient appropriate audit evidence had not been obtained to support the conclusion reached on the loan recoverability assessment.



Good Practice



Companies that manage this area well usually focus on building a disciplined credit assessment process rather than treating impairment as a year-end adjustment exercise.

Good practice generally includes:

- defining clear staging criteria;
- monitoring both quantitative and qualitative credit indicators;
- updating macroeconomic assumptions regularly; and
- validating ECL models against actual loss experience.

For inter-company loans, companies should perform proper financial analysis of the borrower, including projected cash flows, debt servicing ability, liquidity position, and future funding requirements.

Board intent or management optimism should not replace financial evidence.

Where loan terms change, companies should also document whether the modification affects the accounting treatment under Ind AS 109.

Most importantly, the ECL exercise should reflect economic reality. The objective is not simply to maintain the carrying value of financial assets, but to assess whether the expected recoverability of those assets has changed over time.



Related Party Transactions



Related party transactions are a normal part of business, especially in groups with multiple subsidiaries, promoter-controlled structures, or closely connected management teams. Companies may share resources, provide financing, lease properties, or enter into service arrangements with entities connected to promoters or key management personnel.

The accounting issue is not whether these transactions should exist. The real issue is whether they are:

- properly identified;
- appropriately approved;
- transparently disclosed; and
- conducted on terms that can be reasonably supported.

Many inspection observations suggest the primary concerns are process, governance, and documentation, rather than technical accounting interpretation.



Understanding the Accounting Framework

Related party disclosures are governed by Ind AS 24, Related Party Disclosures. The standard requires companies to disclose relationships with related parties, transactions entered into with them, outstanding balances, and the terms and conditions attached to those arrangements. Related parties can include subsidiaries, associates, joint ventures, promoters, key management personnel (KMP), close family members of KMP, and entities controlled or influenced by such individuals. The purpose of the standard is straightforward- users of financial statements should understand whether the company's financial position or performance has been influenced by transactions that may not have occurred on normal market terms. Ind AS 24 does not prohibit related party transactions. It requires transparency around them.

Why This Area Becomes Difficult in Practice



Identifying All Related Parties

One of the biggest challenges is completeness. In many organizations, the finance team depends heavily on management declarations to identify related parties. However, relationships may change during the year because of new appointments, resignations, restructuring, acquisitions, changes in shareholding, or indirect ownership arrangements.

As a result, some related parties may not be captured fully. Inspection findings often identify situations where:

- transactions with promoter-linked entities were missing;
- entities connected through family relationships were not identified; or
- unusual payments were made to parties that had not been classified as related parties at all.

The challenge becomes greater in complex group structures where ownership and influence are spread across multiple entities. That is why relying only on a static related party list is usually not enough.



Arm's-Length Assessment

Another recurring issue is the assumption that a transaction is automatically at arm's length simply because it was approved internally. Under Ind AS 24, companies can state that transactions were conducted on arm's-length terms

only if they have evidence to support that conclusion. In practice, this supporting evidence is often limited or absent. For example:

- loans may be given without proper benchmarking of interest rates;
- rent agreements with promoter-linked entities may not be compared with market rentals; or
- management service fees between group companies may lack a clear pricing basis.

A board approval confirms that management approved the transaction. It does not by itself prove that the pricing was commercially comparable to market terms.



Disclosure Quality

Another issue is generic disclosure. Some financial statements disclose large, related party balances or transactions without clearly explaining the nature of the relationship, the purpose of the transaction, repayment terms, security arrangements, or whether balances are recoverable. Users of financial statements should be able to understand not only that a transaction occurred, but also its commercial substance and financial impact.



Governance and Commercial Substance

Related party transactions also carry governance risk. Transactions involving connected parties may sometimes:

- bypass normal commercial discipline;
- shift profits between entities;
- support financially stressed group companies; or
- benefit promoters indirectly.

That is why regulators expect stronger scrutiny in this area. Even if accounting entries are technically accurate, inadequate governance controls can undermine financial reporting reliability; therefore, enhancing control frameworks is essential.





Illustrative Scenario: Manufacturing Company Leasing Property from a Promoter-Linked Entity

A listed manufacturing company leases its corporate office to a private company in which the Managing Director's spouse holds a majority stake.

The annual rental lease is 4.8 crore.

The financial statements disclose the arrangement as a related party transaction conducted "at arm's length and on commercially reasonable terms."

However, the only support available for this conclusion is a board resolution approving the lease arrangement.

No:

- independent property valuation;
- market rental benchmarking; or
- external comparison for similar office space has been performed.

A later market review indicates that comparable commercial properties in the same area were available at substantially lower rentals. In this situation, the concern is not whether the transaction was disclosed. The larger issue is whether the arm's-length assertion was adequately supported. Without independent benchmarking or market evidence, the company may find it difficult to justify the conclusion reached under Ind AS 24.



Good Practice

Companies that manage related party transactions well usually treat the process as both an accounting and governance responsibility.

Good practice generally includes:

- maintaining dynamic related party lists;
- monitoring changes in ownership and management structures;
- reviewing unusual transactions carefully; and
- independently validating significant related party arrangements.

For transactions claimed to be at arm's length, companies should retain proper supporting evidence such as market quotations, valuation reports, comparable pricing analysis or independent benchmarking studies.

Disclosure quality is equally important. Financial statement users should be able to clearly understand who the related party is, why the transaction occurred, the value involved and whether any ongoing exposure remains.

In many inspection findings, the issue is not hidden complexity. The issue is that companies treat related party compliance as a disclosure checklist rather than a broader transparency exercise under Ind AS 24.



Going concern is one of the most fundamental assumptions in financial reporting. When financial statements are prepared, there is an underlying expectation that the company will continue operating for the foreseeable future and will be able to realize its assets and settle its liabilities in the normal course of business.

When that assumption becomes uncertain, the impact goes far beyond a single disclosure note. It affects how users interpret the entire financial position of the company. NFRA inspection findings in this area often point to the same underlying issue: management assessments that rely too heavily on future expectations without enough supporting evidence.

In many cases, companies continue preparing financial statements on a going concern basis even though there are visible signs of financial stress. The problem is not always the conclusion itself. The issue is that the assumptions, forecasts, and mitigating plans supporting the conclusion are not sufficiently robust or transparent.



Understanding the Accounting Framework

Going concern assessment is governed primarily by Ind AS 1, Presentation of Financial Statements. Under Ind AS 1, management must assess at each reporting date whether the company can continue operating as a going concern.

Financial statements are generally prepared on a going concern basis unless:

- management intends to liquidate the company;
- cease operations; or
- has no realistic alternative but to do so.

Importantly, there is a difference between using the going concern basis of accounting and disclosing a material uncertainty related to going concern. A company may still prepare its financial statements on a going concern basis while also disclosing that significant uncertainties exist. This distinction is important because companies sometimes assume that if they continue using the going concern basis, no additional disclosure is required. That is not necessarily correct under Ind AS 1.



Indicators of Going Concern Risk

Certain financial and operational indicators usually require a deeper assessment.

These may include recurring operating losses, negative operating cash flows, net current liabilities, overdue borrowings, breach of loan covenants, dependence on short-term funding, inability to refinance debt, or significant pending liabilities.

No single indicator automatically means the company is no longer a going concern. However, when several of these conditions exist together, management is expected to perform a detailed assessment supported by evidence. Inspection findings often identify situations where these warning signs were present but the assessment remained largely qualitative or overly optimistic.



Management Mitigation Plans



Once risk indicators are identified, companies generally rely on mitigation plans to support the going concern assumption. These plans may include raising additional financing, restructuring debt, obtaining promoter support, reducing costs, improving working capital, or securing new customer contracts.

The key question is whether these plans are realistic and sufficiently supported at the reporting date. For example:

- a proposed funding arrangement should ideally be supported by lender discussions or documentation;
- projected cost savings should be backed by approved operational plans; and
- expected revenue improvements should have a credible commercial basis.

A mitigation plan based entirely on future intentions without evidence becomes difficult to rely upon. NFRA observations in this area often highlight situations where management assumptions were accepted without enough independent support.



Reliability of Cash Flow Forecasts

Most going concern assessments eventually depend on cash flow projections.

This makes forecast quality extremely important. Management forecasts should be evaluated not only for what they project but also for how reliable similar forecasts have been historically.

For example, if previous forecasts consistently assumed aggressive revenue growth, major cost reductions or refinancing arrangements that never materialized, then the current forecast may require greater scrutiny. A forecast should also consider downside scenarios rather than assuming only favorable outcomes.

Inspection observations often note that going concern assessments are sensitive because they require concurrent success across multiple favorable assumptions.



Illustrative Scenario: Textile Company Facing Liquidity Pressure

A mid-sized textile manufacturer has reported operating losses for three consecutive years. Its working capital facilities are almost fully utilized, and the company is seeking additional funding from its banking consortium to continue operations.

Management prepares a going concern assessment based on three assumptions:

- a major export contract expected to be finalized shortly;
- a planned cost reduction programme; and
- approval of enhanced bank financing.

However, the export contract has not yet been signed, the cost reduction programme has not been formally approved, and the lenders have not provided final confirmation of additional funding. Despite these uncertainties, the financial statements contain only a brief generic statement that management expects the company to continue as a going concern. Under Ind AS 1, this situation would likely require more detailed disclosure of the uncertainties involved. The issue is not necessarily that the company must stop using the going concern basis. The concern is whether users of the financial statements are being given a clear picture of the risks and dependencies that exist at the reporting date.



Companies that handle going concern assessment well usually begin the process early rather than treating it as a year-end formality.

Good practice generally includes:

- monitoring liquidity indicators regularly;
- updating cash flow forecasts throughout the year;
- stress-testing key assumptions; and
- documenting management mitigation plans properly.

Where future funding or refinancing is important, companies should maintain supporting evidence such as lender communication, approved term sheets, board-approved restructuring plans, or formal shareholder support commitments.

Disclosure quality also matters significantly. Under Ind AS 1, disclosures should clearly explain the nature of the uncertainty, the assumptions involved, the status of mitigation plans, and the factors that could affect future liquidity.

Generic language rarely helps users understand the actual risk position. In many inspection findings, the issue is not that companies ignore going concern entirely. The issue is that the assessment became a compliance exercise instead of a realistic evaluation of whether the business can continue operating under existing conditions.



Closing Thoughts



The areas covered in this article, Revenue Recognition, Goodwill and Intangible Assets, Inventory, Loans and Expected Credit Losses, Related Party Transactions, and Going Concern, are not niche accounting topics. They appear in the financial statements of most large companies and continue to feature prominently in NFRA inspection observations across industries.

What makes these areas difficult is not the absence of accounting guidance. The standards themselves are generally clear in principle. The challenge usually lies in applying them to real business situations involving judgement, estimates, operational complexity, and incomplete information. Across all six areas, a few common themes repeatedly emerge. The first is completeness. Whether it is identifying all related parties, capturing all contract modifications, assessing all inventory locations, or evaluating all indicators of credit deterioration, the starting point matters. Even a technically strong assessment can fail if the underlying population itself is incomplete.

The second is the quality of assumptions and estimates. Many accounting conclusions depend on forecasts, management judgement, and future expectations. Revenue projections, impairment models, expected credit loss calculations, and going concern assessments are only as reliable as the assumptions supporting them. Assumptions lacking sufficient support are not always immediately identifiable and frequently become apparent during stress scenarios or comprehensive regulatory reviews. The third is documentation and evidence. In many inspection findings, the issue is not necessarily that the conclusion was impossible to support.

The issue is that the supporting analysis was either insufficient, inconsistent, or not documented clearly enough to demonstrate how the conclusion was reached. Finally, disclosure quality remains critical. Financial statements are not only a compliance exercise. Their purpose is to help users understand the economic reality of the business, including the risks, uncertainties, and significant judgements involved. Generic disclosures copied from accounting standards rarely achieve that objective.

For finance teams, accounting professionals, and auditors, the broader lesson from inspection findings is that financial reporting quality is usually built much earlier than the finalization stage. Strong outcomes generally come from:

- 01 timely assessment;
- 02 continuous monitoring;
- 03 realistic assumptions;
- 04 cross-functional coordination; and
- 05 disciplined documentation throughout the reporting cycle.

The accounting standards establish the framework, but the quality of financial reporting ultimately depends on how thoughtfully and consistently that framework is applied in practice.

ABOUT US

Pierag Consulting was founded in February 2021 by Abhishek Gupta, Thomas Raffa and Pierian Services as a unique business model to serve clients globally by blending domestic proficiency with global expertise. Since then, we have been serving prominent clients across the US, SEA, India and UK in the field of Accounting Advisory, Business Risk, Technology Risk, Assurance, ESG & Sustainability, Deals Advisory, Tax and Digital.

With highly skilled team members, we are fueled by our purpose of 'Inspiring people to do things that inspires them' and our values of 'Excellence, Equity & Empathy'.

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