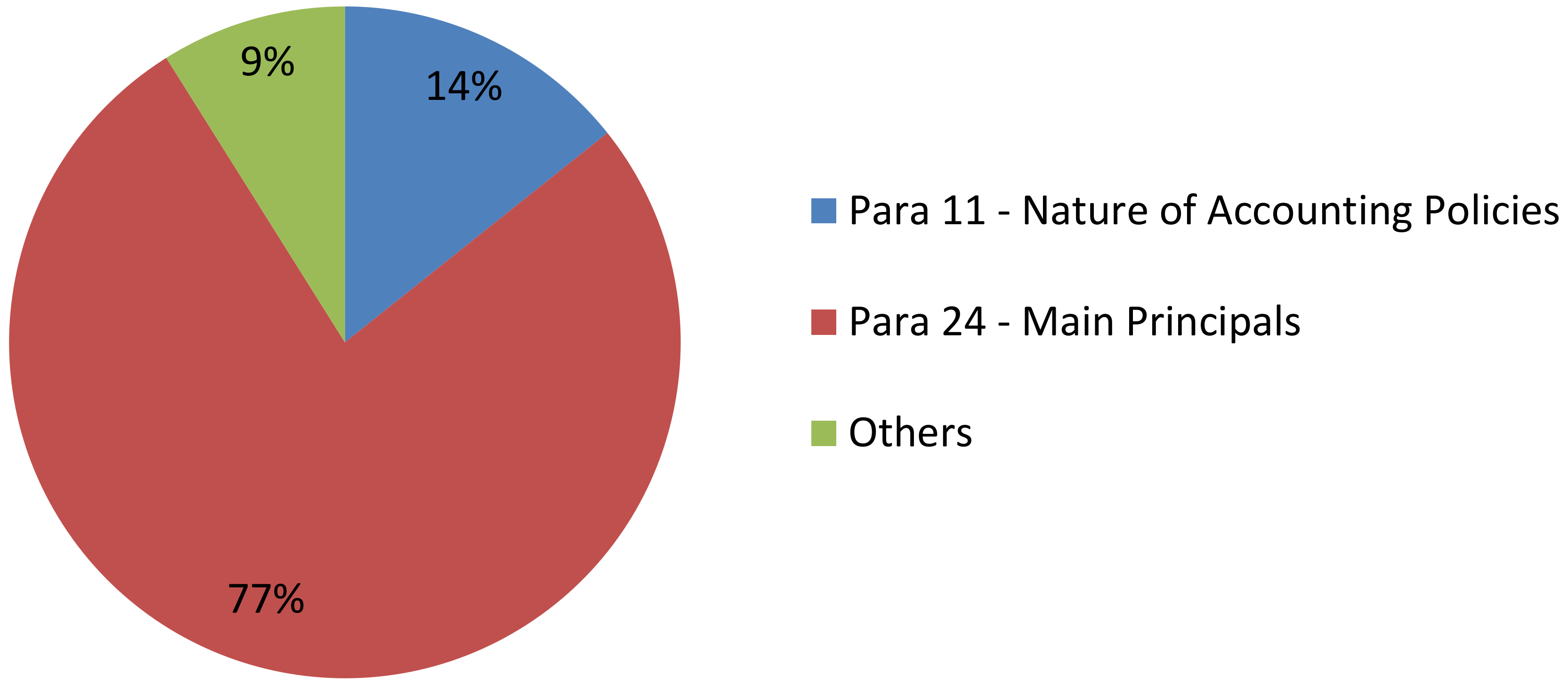
Common Non-Compliances on Accounting Standards in the General Purpose Financial Statements as Observed by FRRB

Financial Reporting Review Board (FRRB)

Non - Compliance of Accounting Standard

AS 1 - Disclosure of Accounting Policies

Deficiencies observed : at a glance



Case:

In one of the Annual Report the accounting policy is stated as follows:

"The unrealised loss on outstanding derivative contracts had not been recognised in the books, considering the principles of prudence as enunciated in AS 1. "

Principle:

Paragraph 17 of AS 1

Observation:

It was viewed that as per paragraph 17 of AS 1 **prudence norms prohibit recognition of future expected profits but not the recognition of future expected losses**. Accordingly, in the stated policy the prudence principles of AS 1 has not been correctly interpreted.

Case:

Subsidies granted by the government for providing telecom services in rural areas are recognized as other operating income in accordance with the relevant terms and conditions of the scheme and arrangements.

Principle:

Paragraph 24 of AS 1

Observation:

The timing of recognition of such grant is not clear from the stated policy. Such policy only provides a means to understand the accounting policy adopted for recognition of government grant, rather than explicitly disclosing the principles adopted for the same. Accordingly, it was viewed that the requirements of AS 1 has not been complied with.

Case:

The accounting policy on revenue recognition states that the revenue is recognised on accrual basis. Further, company is mainly engaged in transmission of power wherein revenue is recognised on basis of tariff orders notified by appropriate authorities, and in case final orders are pending for notification, then transmission income is often accounted on provisional basis as per tariff norms.

Principle:

Paragraph 24 of AS 1

Observation:

It was noted that **policy on revenue recognition is not correct as it does not state timing of revenue recognition**. Further, accounting policy on recognition of revenue from power transmission business fails to explicitly explain the situation as to how the revenue is recognized in case of final order is pending.

Case:

Certain companies omit to disclose significant accounting policies with regard to the following:

- Borrowing Costs
- Valuation of Inventories
- Accounting for Investments
- Employee Benefits
- Accounting for taxes on income
- Impairment of Assets
- Provisions, Contingent liabilities and Contingent Assets

Principle:

Paragraph 24 of AS 1

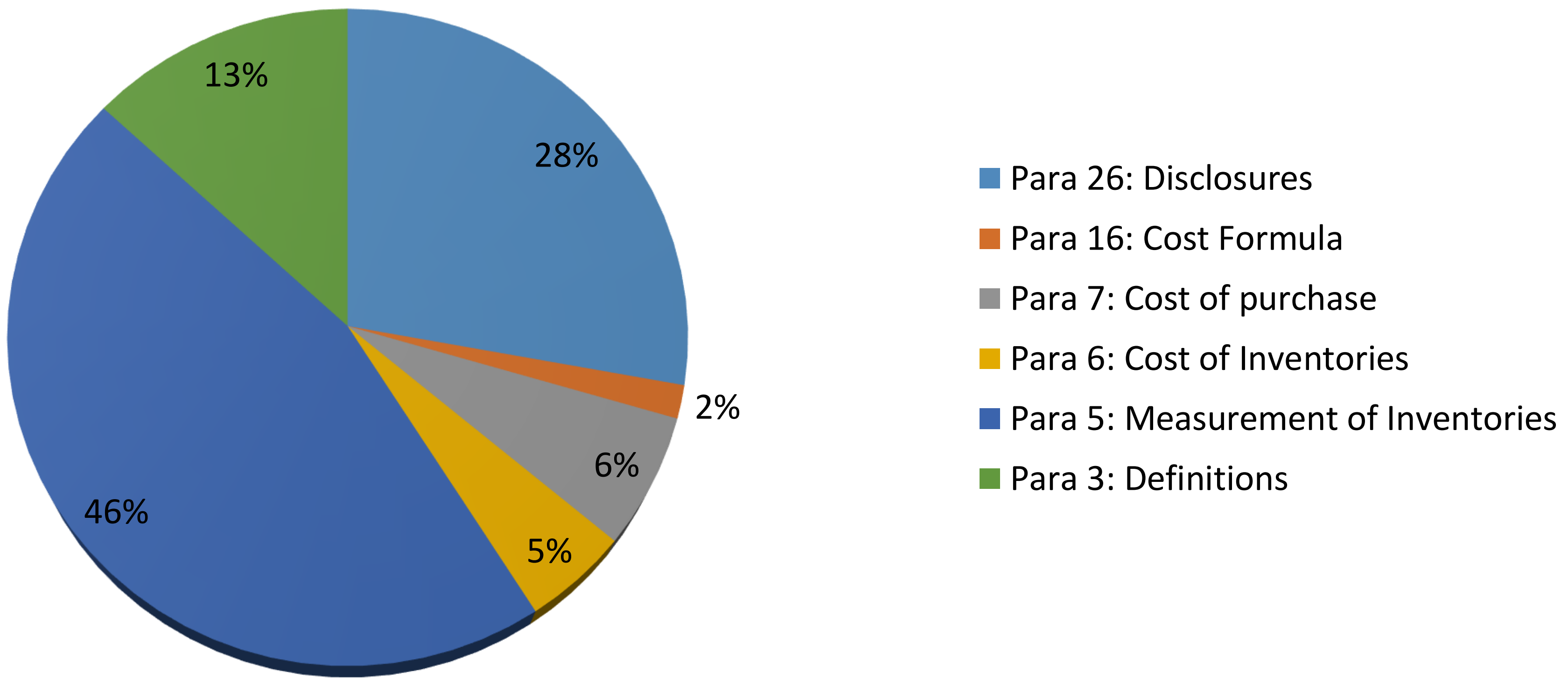
Observation:

It was observed that company in general, may have borrowed funds, inventories, investments, employees, taxes on income and assets which may be subject to impairment. Further, there is always a need to carry certain provisions for meeting the contingent liabilities**. As per Paragraph 24 of AS 1, all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed. Accordingly, subject to circumstances, a company is expected to disclose the accounting policies as adopted by it with regard to each of them.**

Non - Compliance of Accounting Standard

AS 2 - Inventories

Deficiencies observed : at a glance



Case:

Incorrect disclosure of valuation of Inventories

Principle:

Paragraphs 3.2, 5 and 6 of AS 2

Observation:

The accounting policies regarding valuation of inventories as disclosed in the Annual Report of several companies are listed below:

- Stocks of Cards are **valued at *Cost*** and on FIFO basis and include all applicable overheads in bringing the inventories to their present location and condition. Work in progress is valued at *Cost.*
- Work - in - Progress is **valued at direct raw material cost** and appropriate cost of completed process.
- Raw materials are **valued at average cost**. Raw materials at bonded warehouse stores, spares, consumables, packing material, coal & fuel are valued at cost.
- Work in Process **is valued at raw material cost**.
- Cost of finished goods and work in progress are determined on **estimated cost basis**.
- Cost is determined by using the first in first out formula. **Cost comprises all**.

It was noted from the given accounting policies that inventories have been valued at cost or average cost. In other words **'net realisable value' has not been considered for the purpose of valuation of these inventories**.

Further, in some of these cases given above, **it is not clear from the stated accounting policies whether all the applicable costs as per paragraph 6 of AS 2 have been considered or not.**

Accordingly, it was viewed that the valuation of inventories in all these cases is not in line with the requirements of AS 2.

Case:

Non consideration of excise duty in valuation of Inventories

Principle:

Paragraph 7 of AS 2 read with paragraph 18 of the Institute's **'Guidance Note on Accounting Treatment for Excise Duty**,' which is given below:

"the liability for excise duty arises when the manufacture of the goods is completed; hence, it is necessary to create a provision for liability of unpaid excise duty on stocks lying at the factory or bonded warehouse."

Observation:

In the Annual Reports of some companies following notes have been given with regard to accounting treatment of excise duty in inventory valuation:

- The liability for **excise duty on finished goods lying in stock at the close of the year has not been provided for in the accounts and hence not included in the valuation of inventory** of such products. However, the said liability, if accounted, would have no impact on profit for the year.
- **Liability for excise duty on finished goods is accounted as and when they are cleared from the factory premises**. No provision is made in the account for goods manufactured and lying in factory premises.
- Raw material and finished goods are **valued net of excise duty**.

It was noted from the given notes that excise duty has neither been considered in the valuation of inventories nor provided for in the books of accounts, which is not in line with the requirements of paragraph 7 of AS 2 as well as paragraph 18 of the Guidance Note on Accounting Treatment for Excise Duty.

Case:

Incorrect disclosure of cost formula of Inventories

Principle:

Paragraph 16 and 26 of AS 2

Observation:

From the Annual Reports of some companies following accounting policies have been noted:

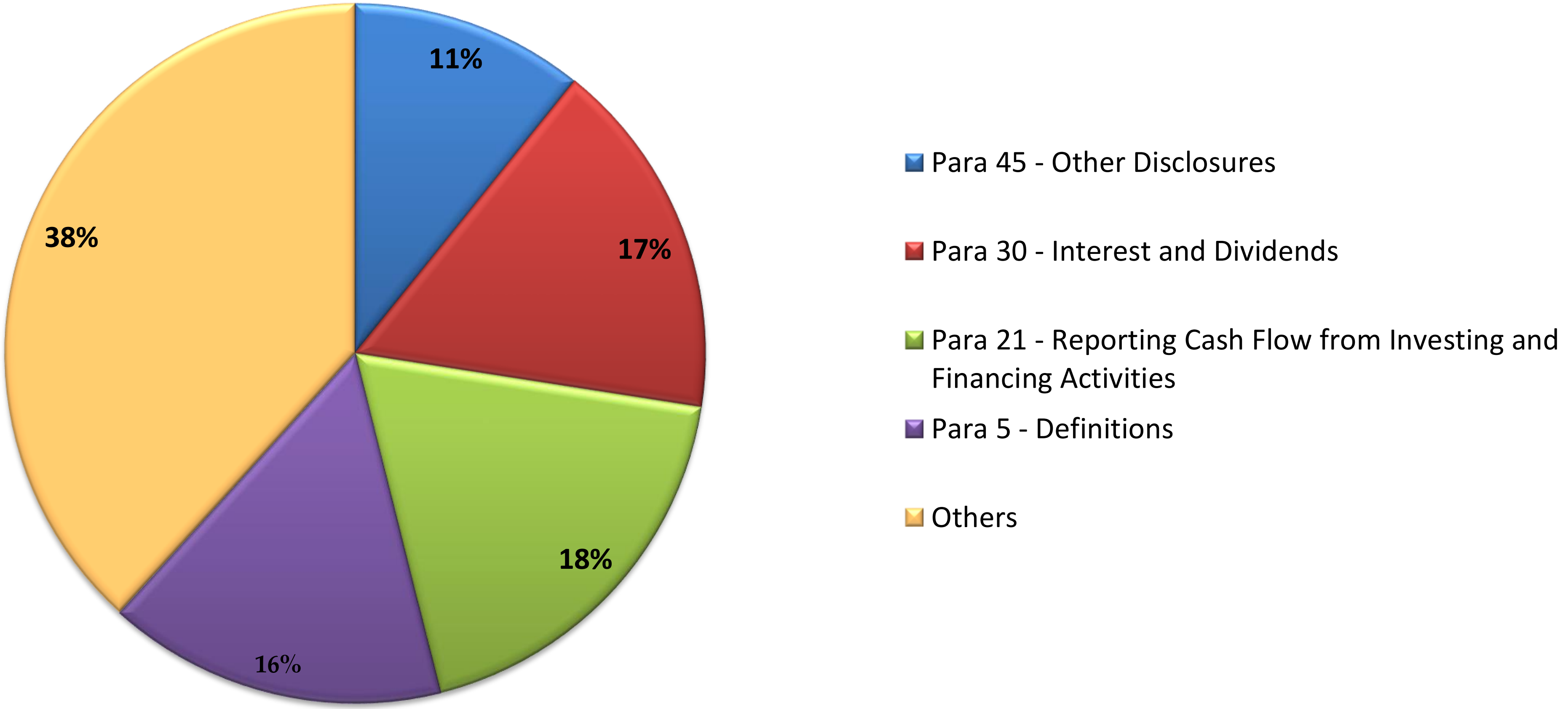
- Inventories are stated at lower of cost and net realisable value. **Cost is determined on weighted average/ first-in first-out (FIFO) basis, as considered appropriate by the Company.**
- Cost of inventories is computed on **weighted average / FIFO basis**.

It was viewed that although cost formula has been given in these cases, however, it would be more appropriate to disclose which cost formula has been used for which class of inventories.

Non - Compliance of Accounting Standard

AS – 3 Cash Flow Statements

Deficiencies observed : at a glance



Case:

From the Cash Flow Statement given in the Annual Report of a Bank, it has been noted that net '(Increase)/Decrease in Investments' has been disclosed under the head 'Cash Flow from Operating Activities.' Further, it has been noted from the note on Investments that such investments also include 'Held to maturity' investments.

Principle:

Paragraphs 5.4 and 5.5 of AS 3

Observation:

It was viewed that **only the cash flows arising from purchase/ sale of investments which are in the nature of 'available for sale and held for trading' should be classified as 'Cash Flow from Operating Activities'** and those acquired on account of sale/ purchase of '**held to maturity' investments should not be considered as cash flow from revenue generating activity** of the bank due to its long term nature. Such activities are in the nature of investing activities and therefore should be classified as 'Cash Flow from Investing Activities'.

Case:

From the Note on Non-Current Investments and its footnote, it has been noted that during the year all the equity shares in three enterprises were purchased, thus, making them as wholly owned subsidiaries. It was further noted from the cash flow statement that the difference between opening and closing balances of ‘investments in subsidiaries’ have been shown as ‘purchase of investments’ in the Cash Flow Statements and there was no indication of any sale of investment.

Principle:

Paragraph 37 of AS 3

Observation:

It was viewed that **since such cash flows result into acquisition of enterprises, it should have been presented separately** clearly indicating the nature of cash flows as explained in the aforesaid requirement rather than using generic head of ‘purchase of investments’.

Case:

In the note on Administrative and Other Expenses, there is an item Exchange Fluctuation (net) amounting to Rs. XXX, however, the same has not been adjusted to determine cash flow from operating activities in Cash Flow Statement.

Principle:

Paragraph 27 of AS 3

Observation:

It was viewed that the entire amount cannot be considered to comprise of only realised foreign exchange gain/ loss unless such information has been provided. Hence, the unrealised foreign exchange loss should have been adjusted to determine cash flow from operating activities as per the requirements of AS 3.

Case:

From the Annual Report of a company, it was noted that the Cash and Bank balance included balances in foreign currencies. However, there was no adjustment/ reconciliation shown in the Cash and Cash Equivalent for 'exchange rate difference'.

Principle:

Paragraph 25 of AS 3

Observation:

The effect of **changes in exchange rates thereon has not been reported as part of reconciliation of changes in cash and cash equivalents** while reporting cash flows in Cash Flow Statement.

Case:

In the Cash Flow Statement of a non financial enterprise, under the heading of financing activities, an item interest (net) amounting to Rs. XXX has been reported.

Principle:

Paragraph 30 of AS 3

Observation:

It was viewed that the **cash flows from interest income has arisen due to investing activity while the cash flows from interest expense, has arisen due to financing activity hence, they can not be netted off against each other.**

Case:

Certain companies although are disclosing dividend paid under the heading 'Cash Flow from Financing Activities', have disclosed' tax on dividend paid (corporate dividend tax)' under the heading 'Cash Flow from Operating Activities'.

Principle:

Paragraph 34 & 35 of AS 3

Observation:

Tax on dividend paid (corporate dividend tax) should be shown along with the dividend paid in the Cash Flow Statement under the 'Cash Flow from Financing Activities'. It is not correct to show this amount as 'Cash Flow from Operating Activities' while dividend paid is disclosed as 'Cash Flow from Financing Activities'.

Case:

In one of the enterprise, the components of Cash and Cash equivalents as reported in the balance sheet includes Cash in Hand, Cash at Bank, Earmarked Balance against LC, Gratuity & Superannuation etc., Unpaid Dividend Account, Interest accrued on Fixed Deposits and the total of these components matches with the closing cash & cash equivalents as reported in the cash flow statement.

Principle:

Paragraph 5.2 of AS 3

Observation:

It was observed that the balance of 'Cash and cash equivalents' as reported in the Cash Flow Statement is same as that in the balance sheet i.e. Rs. XXX. Further, it was noted from the components of cash and cash equivalents that it includes **balances of unpaid dividend, accrued interest on FDs and earmarked balances against LC, Gratuity & Superannuation etc. which are not readily available with the enterprise for its use, thus, the same cannot be included in 'Cash and Cash Equivalents'.**

Case:

In one of the non-financial enterprise, Decrease/ (Increase) in long term loans and advances has been adjusted as working capital changes under the head 'cash flow from operating activity.' Further, the cash flows arising from the same have been shown on net basis in the Cash Flow Statement.

Principle:

Paragraph 15 (e) & (f) and paragraph 21 of AS 3

Observation:

For a non-financial enterprise, **long term loans and advances are in the nature of investing activity and it cannot be considered as a part of revenue generating activities**. Therefore, such cash flows should not be shown under the head 'cash flow from operating activities'. It is not in line with paragraph 15 of AS 3.

Further, it was also noted that such cash flows have been shown on net basis. It was viewed that **separate figures of gross receipts and repayments of long term loans and advances, should have been disclosed separately** as required under paragraph 21 of AS 3.

Case:

In certain enterprises, the Cash & Cash equivalent as reported in the Notes and Cash Flow Statement does not tally and reconciliation was not given.

Principle:

Paragraph 42 of AS 3

Observation:

There is a mismatch between the amounts of Cash & Cash Equivalent reported at two places in the same set of financial statements. It was viewed that **since the balances do not tally with each other, therefore, the reconciliation should have been provided** for better understanding of the reader of the financial statements.

Case:

From the Cash Flow Statement of a finance company it has been noted that changes in ’borrowings’ (including debt raised for Tier II Capital) were disclosed under ’Cash Flow from Operating Activities’.

Principle:

Paragraph 17 of AS 3

Observation:

It was viewed that **cash flow on account of borrowings in case of all enterprises whether financial or non-financial enterprises, should be presented as cash flow from ‘financing activities’ as the definition of ‘financing activities’ in AS 3 does not make any distinction between financial and non-financial enterprises**. Accordingly, classifying cash flows from borrowings as ‘operating activities’ is not line with AS 3.

Case:

From the Cash Flow Statement given in the Annual Report of a company it was noted that ’fixed assets lost due to robbery’ were disclosed under the head ’Cash Flow from Investing Activities.’

Principle:

Paragraph 40 of AS

Observation:

It was viewed that loss of fixed assets due to theft/ robbery is a **non cash transaction hence, it should have been excluded from Cash Flow Statement** as per the above-stated requirement.

It was further noted that loss on fixed assets lost in robbery has already been adjusted to determine ‘cash flow from operations’. Hence, showing separate cash outflow for same loss which is a non-cash transaction is unwarranted.

Case:

From the notes to accounts given in the Annual Report of some companies, the following has been noted:

- The provision for doubtful debts, advances written off and unrealised foreign exchange gain has been reported in the Statement of Profit and Loss.
- Certain amount of miscellaneous expenditure has been written off during the year which includes preliminarily expenses and deferred revenue expenditure.

Principle:

Paragraph 20 (b) of AS 3

Observation:

It was observed that although **non-cash items** such as provision for doubtful debts, advances written off, unrealised foreign exchange gain and writing off miscellaneous expenditure have been reported in the Statement of Profit and Loss, however, they **have not been adjusted against Net Profit before tax & extraordinary items in the Cash Flow Statement** while deriving the Cash Flow from Operating Activities.

Case:

From the Cash Flow Statement of a financial enterprise it was noted that the following items were disclosed as ’Cash Flow from Financing Activities’:

- Loan Repayment
- Loan disbursed

Principle:

Paragraph 14 of AS 3

Observation:

It was observed that since company under review is a financial enterprise, loans made and repayment thereof should have been classified as ‘cash flows from operating activities’ rather than ‘cash flows from financing activities’.

Case:

From the Cash Flow statement given in the Annual Report of a company, it was noted that exchange fluctuation reserve & hedging reserve have been adjusted to net profit before tax.

Principle:

Paragraph 18(b) of AS 3

Observation:

It was viewed that **since such reserves have not been routed through the Statement of Profit and Loss, accordingly, these should not have been adjusted for arriving at the operating profits before working capital changes in the cash flow statement.**

Non - Compliance of Accounting Standard

AS 4 - Contingencies and Events Occurring After the Balance Sheet Date

Case:

One of the Notes to Accounts states that it is the Company's Policy to take into account the impact of any significant event that occurs after Balance Sheet date but before the ***finalisation of accounts (emphasis supplied)***.

Principle:

Paragraph 3.2 of AS 4

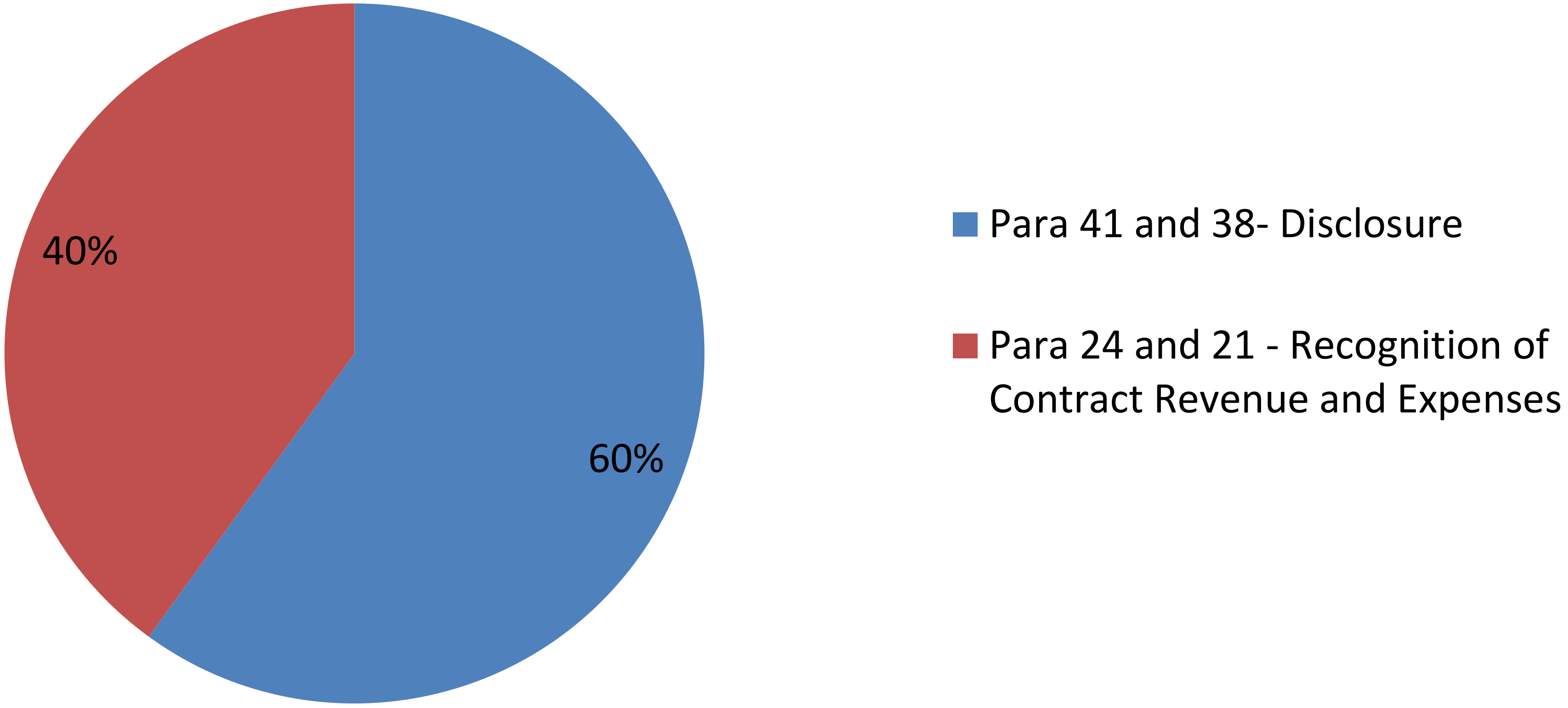
Observation:

It was viewed that events occurring after the balance sheet date are those significant events that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors/ corresponding approved authority. It was viewed that **the date of finalisation of accounts could not be construed as the date when the financial statements have been approved by the Board unless the date of signing the Auditors' Report is same as the date of finalisation of accounts.**

Non - Compliance of Accounting Standard

AS 7 - Construction Contracts

Deficiencies observed : at a glance



Case:

The significant accounting policy relating to construction contracts states as below:

"Job work revenue is accounted on the basis of running bills raised and approved by the clients. Revenue Expenditure is accounted on accrual basis as and when it is incurred."

Principle:

Paragraph 21 of AS 7

Observation:

It was observed that revenue has been recognised based on bills raised and cost has been accounted, as and when incurred, whereas **paragraph 21 of AS 7 requires to recognise revenue and costs based on the stage of completion of the contract activity as on the reporting date**. Thus, the policy regarding construction contracts is not in line with the requirement of AS 7, Construction Contracts.

Case:

From the Annual Report of a company, it was noted that the company is involved in construction business and its Schedule of inventory also include an item of Job in progress. However, no other disclosure was made in the financial statements.

Principle:

Paragraph 39 of AS 7

Observation:

It was observed that **though involved in construction business, company had not made the following disclosures, as is required by Paragraph 39 of AS 7**:

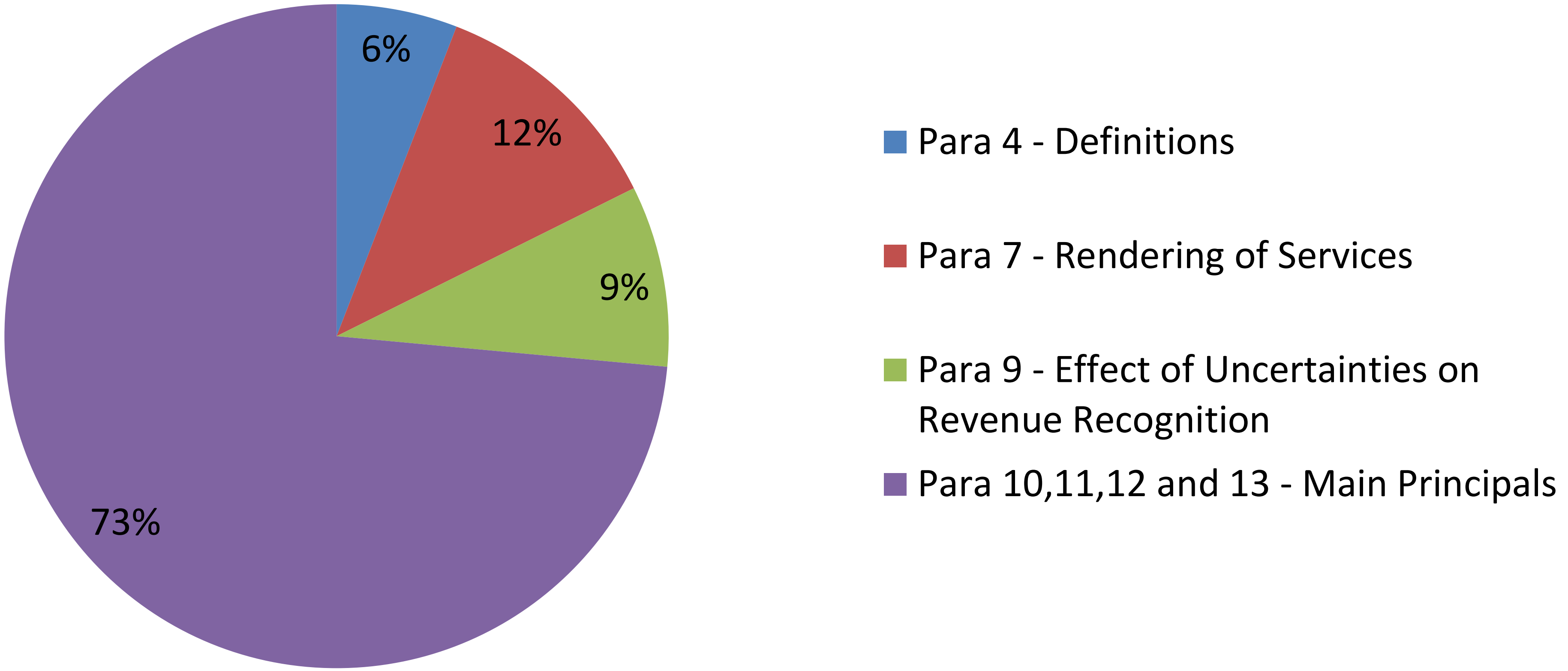
- the aggregate amount of costs incurred and recognised profits (less recognised loses) up to the reporting date;
- the amount of advances received ; and
- the amount of retentions.

Accordingly, it was viewed that the company has not complied with the requirement of AS 7.

Non - Compliance of Accounting Standard

AS 9 - Revenue Recognition

Deficiencies observed : at a glance



Case:

From the Annual Reports of some companies, it has been noted that one of the items of income as shown in the Statement of Profit and Loss is income from advertisement and ticket sales and the related accounting policy states as follows:

‘Revenue from sale of tickets is recognised when the tickets have been sold. Advertisement revenue is recognised when advertisements and net realisation are confirmed.’

Principle:

Paragraph 12 of AS 9

Observation:

It was noted that the enterprise under review render services. Therefore, revenue from sale of tickets should be recognised as per the completed contract method. However, as per the accounting policy adopted by these enterprises, the revenue from sale of tickets is recognised when tickets are sold. It may be noted that tickets are sold before the event takes place. Accordingly, **in case of advance booking of tickets there is always a time gap between the sale of tickets and actual event. Hence, such revenue cannot be considered to have been earned until and unless the event has taken place.** If the event doesn't taken place, it may be necessary even to refund the amount. However, in the given case the enterprise does not consider the happening of the related event for recognition of revenue.

Same principle is applicable to income from advertisement as well. The revenue from advertisements should be recognised when the advertisements is accepted and not on realisation of bills. Thus, recognising revenue when advertisement and net realisations are confirmed is not in line with the requirements of AS 9.

Case:

The accounting policy of revenue recognition as given in the Annual Report of a company *inter alia* states that revenue from online educational services (if charged) is recognised upon receipt of subscription fee (in case of non-refundable) otherwise apportioned over the subscription period.

In the Annual Report of another company, the following accounting policy has been disclosed:

"Revenue from online educational services is recognised upon receipt of subscription fees. ..."

Principle:

Paragraph 7.1 of AS 9

Observation:

From the above, it was viewed that the period when services are rendered should be considered for recognition of revenue. Accordingly, if revenue is received it should be deferred and recognised over the period when services are rendered.

It was further viewed that **the subscription fee for online educational services should be recognised apportioned over the service period.**

Accordingly, it was viewed that the accounting policy followed in these cases is not in line with the requirements of AS 9

Case:

From the Annual Report of a company, it has been noted that the company has recognised as income the entire cost of garments destroyed by fire under other operating income (stock loss claim) based on filing of insurance claim. With regard to partially damaged stocks, the related inventory has been valued at net realisable value and insurance claim against the same is taken as other income. Insurance claim against loss of fixed assets has also been recognised based on the claim filed with the insurance company. The note further states that said income has been recognised as per the AS 9.

Principle:

Paragraph 4.1 and 9.2 of AS 9

Observation:

It was noted that insurance claims do not fall within the definition of ‘Revenue’ as given in AS 9. However, it was viewed that as in the case of sale of goods or rendering of services, the recognition of insurance claims also requires that the amount realisable is measurable and it is not unreasonable to expect ultimate collection. Accordingly, **recognising insurance claims at the time of filing the claims with the insurance company without considering the uncertainty relating to its measurability is not appropriate.**

Accordingly, it was viewed that recognition of revenue at the time of filing of claims is not in line with the principles of AS 9.

Case:

The accounting policies regarding recognition of dividend income has been disclosed as follows in the Annual Reports of some companies:

- Dividend is accounted as and when received.
- Income & Expenditures are recognised on accrual basis except dividend on shares and units of Mutual Funds, which are recognised on cash basis

Principle:

Paragraph 13 of AS 9

Observation:

It was observed that the dividend income has been recognised on receipt basis while **paragraph 13 of AS 9 requires recognition of dividend income when the right to receive payment is established.**

Accordingly, it was viewed that the recognition of dividend income on receipt basis is not in line with the requirements of AS 9.

Case:

The following accounting policies on Revenue Recognition have been disclosed in the Annual Reports of some companies:

- Revenue (income) is recognised when no significant uncertainty as to measurability or collectability exists.
- Revenue/Income and Cost/Expenditure are accounted for on accrual basis.
- Sales are accounted for on dispatch of products.

Principle:

Paragraph 11 of AS 9

Observation:

It was observed in the first case that revenue has been recognised when there is no uncertainty as to measurability and collectability whereas in the second case it simply states accrual basis. However, in none of these cases the timing of recognition of revenue i.e. when the enterprise has transferred significant risk and reward to the buyer has been disclosed. In the last case also, it was not clear whether significant risk and rewards associated with the ownership of goods stands transferred when the products are dispatched.

Thus, it was viewed that the accounting policies for revenue recognition as disclosed in the financial statements are not in line with the requirements of paragraph 11 of AS 9.

Case:

The revenue recognition policy as disclosed in the Annual Report of a company includes the following:

‘Revenue recognition

Profit on sale of Investment is recognised as income in the period in which the investment is sold/disposed off.’

Principle:

Paragraph 4.1 of AS 9

Observation:

It was noted that policy for recognising income from sale of investments has been given under ‘revenue recognition’ policy. It was viewed that such presentation indicates that income from ‘sale of investments’ has been considered as ‘revenue’ for the enterprise.

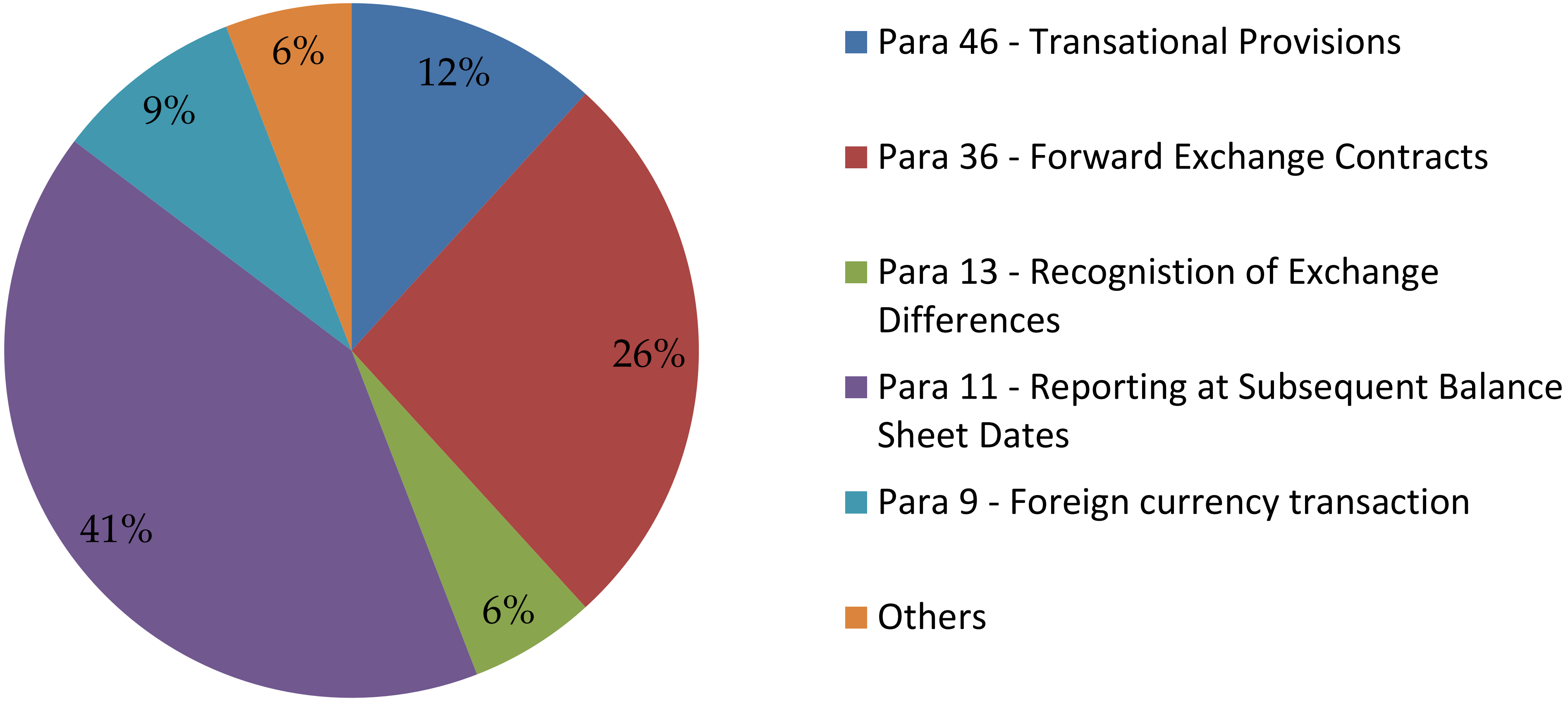
However, from the definition of Revenue, it may be noted that **income from sale of investment cannot be considered as an ordinary activity of the enterprise as such income is neither generated from sale of goods or services or from the use of enterprise resources**.

Accordingly, it was viewed that disclosure of such accounting policy under revenue recognition policy is not in line with the requirements of AS 9.

Non - Compliance of Accounting Standard

AS 11 - The Effects of Changes in Foreign Exchange Rates

Deficiencies observed : at a glance



Case:

From Notes to Accounts given in the Annual Report of a Company, it was noted that certain foreign exchange transactions have been entered during the year.

Principle:

Paragraph 40(a) of AS 11

Observation:

It was noted that the enterprise has entered into various foreign exchange transactions during the year, however, **no exchange gain or loss arising on account of foreign exchange fluctuation has been disclosed separately in the Statement of Profit and Loss or in the notes to accounts, which is not in line with the above stated requirement of AS 11.**

Case:

From the accounting policy given in the Annual Report of a Company, it was noted that the export sales have been recorded at the rate notified by the customs for invoice purposes.

Principle:

Paragraph 9 of AS 11

Observation:

It was noted from the stated accounting policy that the **export sales have been recorded at the rate notified by the customs for invoice purposes instead of translating the same on the basis of exchange rate prevailing on the date of transaction**. This is not in line with the principles enunciated in paragraph 9 of AS 11.

Case:

It was observed from the accounting policy given in the Financial Statement of a company, that current assets and liabilities as at the end of the year are translated at exchange rate ruling on the date of Balance Sheet.

Principle:

Paragraph 11(a) of AS 11

Observation:

As per above referred requirement, **it is only the monetary items which are required to be translated at the closing exchange rate and not all the foreign currency assets and liabilities which may include non-monetary assets/ liabilities as well.** Accordingly, it was viewed that stated policy of translation of all current assets and liabilities at the year end exchange rate is not correct.

Case:

In the accounting policy of foreign currency transactions given in the Annual Report of a Company, it was stated that foreign currency monetary items have been recognised at contracted rates, as those are covered by forward contracts.

Principle:

Paragraph 11(a) of AS 11

Observation:

It was viewed that **hedging contracts (i.e. forward contracts) are independent of underlying contracts and therefore both these contracts should be recognised independent of each other.**

Accordingly, monetary items should have been recognised at the closing exchange rate irrespective of the fact whether risk against such items have been hedged by forward contracts. Hence, recognising monetary item at contract rates is against the principles of AS 11.

Case:

In the Annual Report of a Company, accounting policy for foreign currency transactions for monetary items only have been disclosed.

Principle:

Paragraph 11 of AS 11

Observation:

It was viewed that foreign exchange fluctuation in relation to any asset and liability should be recognized based on their classification as monetary and non-monetary items. It was noted that policy adopted for monetary item was clearly disclosed. However, it **omitted to disclose policy for non-monetary items such as investment in equity shares, inventory and fixed assets which were present in the Balance Sheet.**

Case:

In the accounting policy of foreign exchange, it was stated that if foreign exchange transactions relates to acquisition of fixed assets, they are adjusted to the carrying cost of such assets.

Principle:

Paragraph 46A of AS 11

Observation:

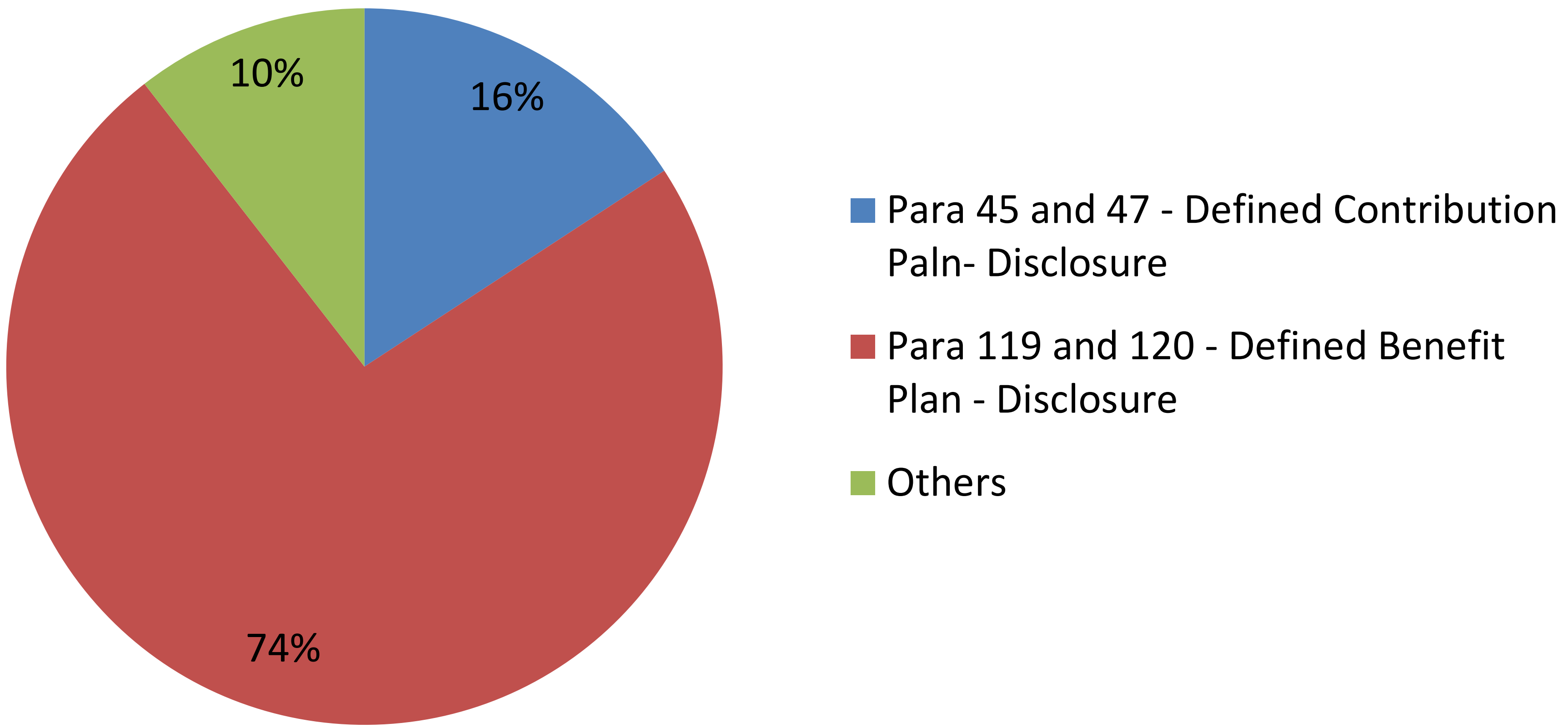
It was noted from the stated accounting policy that the foreign exchange differences related to acquisition of any fixed asset are adjusted to the cost of such assets. It was viewed that **such adjustment is permitted only if such exchange difference has arisen on long term foreign currency monetary items incurred for acquisition of a depreciable fixed asset.**

It was noted that in the given case neither the stated accounting policy nor the Balance Sheet indicates existence of any long term foreign currency monetary item. Hence, adjustment of any foreign exchange rate variation to the cost of fixed asset was not in line with the requirements of AS 11.

Non - Compliance of Accounting Standard

AS - 15 Employee Benefit

Deficiencies observed : at a glance



Case:

The accounting policy relating to employee benefits states as “Annual contributions in respect of provident fund are made to the Life Insurance Corporation of India and are accounted for on accrual basis.”

Principle:

Paragraph 45 of AS 15

Observation:

The accounting policy indicates that liability for provident fund has been recognized based on the contribution to the LIC Scheme. As per Paragraph 45 of AS 15, the **expense of defined contribution plan should be recognized for each period of service rendered by the employees; however, the accounting policy states that such expense has been recognized when the contribution is made to the fund**. It was viewed that such policy does not clearly indicate as to whether the contribution, so made, is the appropriate accrual of liability or not. It is essential because the contribution in excess of what is due is to be recognized as an asset and contribution falling short is to be recognized as liability.

Accordingly, in the given case, it was viewed that requirements of Paragraph 45 of AS 15 have not been complied with.

Case:

In some of the cases the amount of expense for defined contribution were not disclosed by the enterprises.

Principle:

Paragraph 47 of AS 15

"An enterprise should disclose the amount recognized as an expense for defined contribution plan."

Observation:

It was viewed, since paragraph 47 explicitly requires the **disclosure of amount recognized as an expense for defined contribution plan**, the same should be disclosed by way of notes to the accounts.

Case:

In some of the cases although the accounting policy on employee benefits stated that defined benefit obligations has been determined using the services of qualified actuary, however, no disclosure was made regarding whether the projected unit credit method was followed in determination of defined benefit obligations or not.

Principle:

Paragraph 65 of AS 15

"An enterprise should use the Projected Unit Credit Method to determine the present value of its defined benefit obligations and the related current service cost and, where applicable, past service cost."

Observation:

It was viewed that accounting **policy on employee benefits should explicitly mention the fact that projected unit credit method was followed** for determination of defined benefit obligations.

Case:

The accounting policy on gratuity states that "Provision for gratuity is made in the accounts, considering the Balance sheet date as the notional date of retirement".

Principle:

Paragraph 68 of AS 15

Observation:

It has been noted that as per AS 15 the provision for gratuity should be determined through actuarial valuation which should be based on assumption that are not excessively conservative and should reflect the economic relationship considering the factors. It was viewed that the policy adopted by the company indicates that while making provision, it is assumed that each of its employee retire on the balance sheet date which is an excessively conservative assumption and also does not reflect the economic relationship between factors such as inflation, salary increase, the return on plan and discount rates. Since it does not **consider actuarial risk while valuing its liability towards gratuity, it was viewed that actuarial valuation is not followed by the company**. It is against the requirements of AS 15.

Case:

Accounting policy on termination benefits of a company states that payments under Voluntary Retirement Scheme are recognized in the Profit and Loss Account of the year in which such payment are affected

Principle:

Paragraph 134 of AS 15

An enterprise should recognize termination benefits as a liability and an expense when, and only when:

a) *the enterprise has a present obligation as result of past events;*

b) *it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and*

c) *a reliable estimate can be made of the amount of the obligation."*

Observation:

Considering the provision given under paragraph 134 of AS 15, an **enterprise is required to provide for termination benefits on accrual basis**. Accordingly, the recognition of same on payment basis is against the requirements of AS 15 as well as Section 128 of Companies Act, 2013

Case:

From the financial statements of certain companies it has been noted that they do not provide the accounting policy on employee benefits (including defined benefit plans) and in many of the cases reviewed by the FRRB, the disclosures required under Paragraph 120 were not given or partially given by the enterprises

Principle:

Paragraph 119 and 120 of AS 15

Observation:

In majority of the cases it was observed that enterprises have not disclosed the basic information about the defined benefit plan as required under paragraph 119. Further, the description of defined benefit plan and accounting policy adopted for actuarial gains and losses including various other disclosures of paragraph 120 are, *inter alia*, the commonly found mistakes in the financial statements of enterprises.

Non - Compliance of Accounting Standard

AS 16 – Borrowing Cost

Case:

Accounting policy on Valuation of Inventories states that – Finished goods are valued at lower of cost or net realisable value; cost includes depreciation, *interest* (excluding interest on discounting of bills) and direct expenses to the point of stocking, excise duty but excludes administration and selling expenses.

Principle:

AS 2 and AS 16

Observation:

It was noted that interest cost was included in the cost of inventories. **Para 12 of AS 2**,'Valuation of Inventories' provides that interest and other borrowing costs are usually considered as not relating to bringing the inventories to their present location and condition and are, therefore, usually not included in the cost of inventories. **Para 5 of AS 16,** 'Borrowing Costs' provides that those inventories that are routinely manufactured or otherwise produced in large quantities on a repetitive basis over a short period of time, are not qualifying assets. Accordingly**, it was viewed that as per AS 16, no borrowing cost (interest) can be capitalised unless such inventories take a substantial period of time to get ready for sale**. Thus there is a non compliance of AS 2 as well as AS 16.

Case:

Schedule of secured loans as well as related information as given in notes to accounts of a Company, reflects that certain borrowing cost has been incurred during the year, a portion of which has been capitalised to the value of fixed assets and rest of portion has been expensed.

Principle:

Paragraph 23 of AS 16

Observation:

It may be noted that Paragraph 23 of AS 16, requires that the financial statements should disclose:

a) the accounting policy adopted for borrowing costs; and

b) the amount of borrowing costs capitalised during the period."

It was observed **that although the company had capitalized a signification portion of financial charges to the value of fixed assets but omitted to disclose the accounting policy as adopted by it for borrowing cost**. It is not in line with the requirement of paragraph 23 of AS 16.

Case:

Different companies are found to be treating debt restructuring charges/ external commercial borrowings upfront fees as follows:

- Restructuring charges which had been paid to extinguish high cost debts were written-off over the tenure of fresh loans taken for refinancing such high cost debts.

Principle:

Paragraphs 3, 4 (c) and 6 of AS 16

Observation:

It may be noted that paragraph 6 of AS 16, states that Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Statement. Other borrowing costs should be recognised as an expense in the period in which they are incurred."

Further, as per paragraph 3 as well as paragraph 4(c) of AS 16, borrowing costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds and it may includes amortisation of ancillary cost in connection with arrangement of borrowings.

It was noted that **debt restructuring charges paid to extinguish high cost debts were not incurred for the acquisition, construction or production of qualifying assets. In fact, it involves revision in the terms of borrowings. Therefore, such costs are not eligible for capitalisation with the cost of asset.**

Further, it was also viewed that, in any case, AS 16 does not prescribe amortisation of such costs. As such, the treatment followed by the company to defer such expenses is not in accordance with the requirements of AS 16.

Non - Compliance of Accounting Standard

AS 17 – Segment Reporting

Case:

At times, neither the statement on significant accounting policies contain any accounting policy on Segment Reporting nor contain any segmental information.

Principle:

Paragraph 38 of AS 17

Observation:

It was observed that in the absence of any information, one may conclude that either despite the existence of reportable segments no segmental information has been disclosed or there are no reportable segments. Further, it was noted that **explanation to Paragraph 38 of AS 17 requires that where the company has neither more than one business segment nor more than one geographical segment, then, the fact that there is only one 'business segment' and 'geographical segment' should be disclosed by way of the note**. Thus, there is non-Compliance of AS 1 as well as AS 17.

Case:

There were significant differences in the figures of net profit after tax, total assets and total liabilities, as reported in the financial statement as against those reported in the segment report of the enterprise.

Principle:

Paragraph 46 of AS 17

Observation:

As per Paragraph 46 of AS 17, an enterprise should present reconciliation between the information disclosed for reportable segments and the aggregated information in the enterprise financial statements. **In presenting the reconciliation, segment revenue should be reconciled to enterprise revenue; segment result should be reconciled to enterprise net profit or loss; segment assets should be reconciled to enterprise assets; and segment liabilities should be reconciled to enterprise liabilities. In the absence of reconciliation between the figures, it was viewed that the segment report provided is not in accordance with the requirement of AS 17.**

Case:

One of the notes to accounts states that "the company is primarily engaged in the segment of "Iron and Steel Products" and there are no reportable segments as per Accounting Standard (AS 17)." Further, it has been noted from Management Discussion & Analysis Report as well as schedule of sales that the sales comprised of both export sales and domestic sales, which was significant.

Principle:

Paragraph 27 of AS 17

Observation:

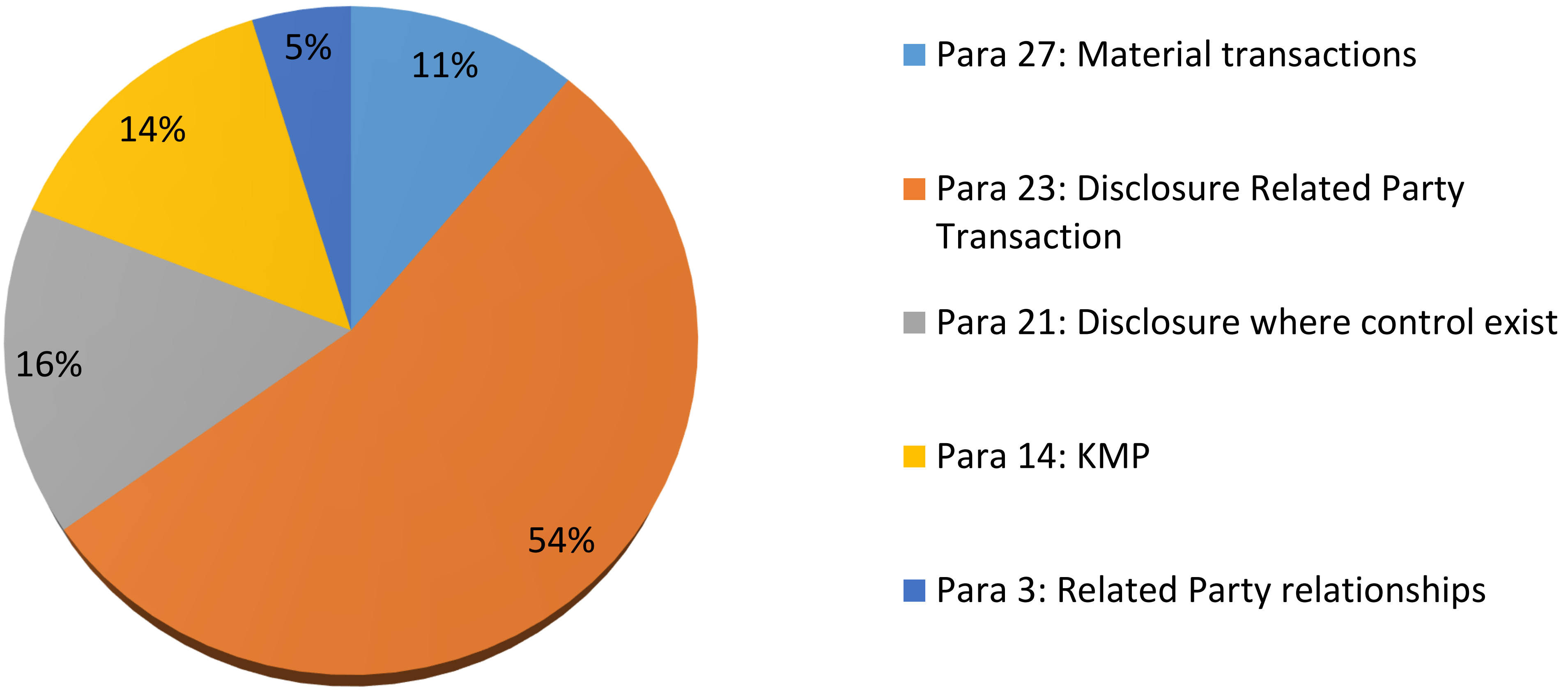
It is evident from the note that the company operates in only one business segment. However, considering the facts, that **both the export as well as domestic sales were significant, it was viewed that the risk and returns of the enterprise are affected by the fact that it operates in other countries apart from India. It shows the presence of geographical segment, which is against the report stated in the notes to accounts.**

Further, it was viewed that in the absence of any business segment, its primary format for reporting segment information would be geographical segments. However, no such reporting has been made which is against the requirements of paragraph 19 of AS 17.

Non - Compliance of Accounting Standard

AS 18 - Related Party Disclosures

Deficiencies observed : at a glance



Case:

Non Disclosure of description of relationship

Principle:

Paragraph 23 (ii) of AS 18

Observation:

From the 'Related Party Disclosures' given in the Annual Report of some companies, it was observed:

- The names of the related parties as well as the transactions that have taken place with such related parties have been disclosed but the **nature of relationship with them has not been disclosed**.
- The **phrase 'Other Related parties' has been used** rather than giving, specific relationship details for parties with whom transactions have taken place.

It was viewed that non-disclosure of a description of the relationship between the parties is not in line with the requirement of paragraph 23(ii) of AS 18.

Case:

Non disclosure of certain Related Parties

Principle:

Paragraph 21 of AS 18

Observation:

From the information given in the Annual Report of some companies, the following discrepancies have been noted:

- It has been noted that certain companies are subsidiaries of other companies. However, **the name of the holding company was not disclosed in the Related Party Disclosures**.
- From the Annual Report of a company, it has been noted that a wholly owned subsidiary has been formed during the year under review; however, the **name of the subsidiary has not been disclosed as a related party** under the Related Party Disclosures.

It was viewed that non-disclosure of the names of the holding company or the subsidiary company in the 'Related Party Disclosures' is not in compliance with the requirements of paragraph 21 of AS 18.

Case:

Non disclosure of Related Party Transactions

Principle:

Paragraph 23 of AS 18

Observation:

The following information/ transactions have been noted from Notes to Accounts, Cash Flow Statement, Director's Report, Corporate Governance Report given in the Annual Reports of different companies:

- Advances given to directors;
- Application money received from KMP for preferential allotment;
- Equity shares allotted to KMP on conversion of warrants;
- Dividend paid to the holding company;
- Loans and advances given to as well as repaid by the subsidiary;

It was viewed that all these transactions are in the nature of related party transactions and although these transactions have been reported in various parts of the Annual Reports, no disclosure has been made under Related Party Disclosures.

Case:

Non compliances relating to KMP

Principle:

Paragraph 14 of AS 18

Observation:

From the information given in Annual Reports of some companies, following has been noted:

- The **managing director or the whole time directors or the manager have not been identified as key management personnel** and consequently the remuneration paid to them or any other transactions with them have not been disclosed under 'Related Party Disclosure'.
- The Chief Operating Officer (COO) has been reported as KMP, however, **the Chief Executive Officer (CEO) who appears to have the authority and responsibility for planning, directing and controlling the activities of the company has not been identified as KMP**.
- The transactions (i.e. remuneration) with the KMP have not been disclosed under Related Party Disclosures, instead **only a reference to the note on managerial remuneration has been given**.

It was viewed that in the given cases, the disclosure requirements of AS 18 with regard to key management personnel have not been complied with.

Case:

Non-Disclosure of material transactions

Principle:

Paragraph 27 of AS 18 read with explanation thereon

***Observation*:**

From the Annual Reports of some companies, it has been noted that under the 'Related Party Disclosures' transactions of similar nature along with the values thereof have been disclosed on an aggregate basis against each type of related party.

It was viewed that, **if any transaction with an individual party constitutes 10% or more of the total related party transactions of same nature then it is a material transaction with that party**, accordingly, the names of the related parties with whom such transactions have taken place and the volume of each such material transaction need to be disclosed separately.

Case:

Incorrect disclosure of nature of Related Parties

Principle:

Paragraph 3 of AS 18

Observation:

From the 'Related Party Disclosures' as given in the Annual Reports of some companies, following nature of the relationships were note:

- Common Director;
- Affiliates

It may be, noted that paragraph 3 does not include any nature of relationship as 'Common Director' or 'Affiliates'. It was, therefore, viewed that the relationship with the related parties is not clear from such descriptions.

Case:

Non Disclosure of outstanding items pertaining to related parties at the balance sheet date

Principle:

Paragraph 23(vi) of AS 18

Observation:

From the 'Related Party Disclosures' in the Annual Report of some companies, it has been noted that **while the volume of transactions with the related parties has been disclosed, the year end balances due to/ from the related parties in respect of the loans and advances received/ given from/ to such parties or in respect of other payables or receivables have not been disclosed.**

It was viewed that the amounts outstanding at the balance sheet date should be disclosed as part of the related party disclosure.

Case:

Disclosure of two related parties under single column

Principle:

Paragraph 23(vi) of AS 18

Observation:

From the ‘Related Party Disclosures’ as given in the Annual Report of a company, it has been noted that **the transactions with the controlling companies and fellow subsidiaries have been disclosed together in a single column. It was viewed that transactions for each type of relationship should be separately disclosed under the related party disclosures.**

Case:

Disclosure of lessor as Related Party

Principle:

Paragraph 3 of AS 18

Observation:

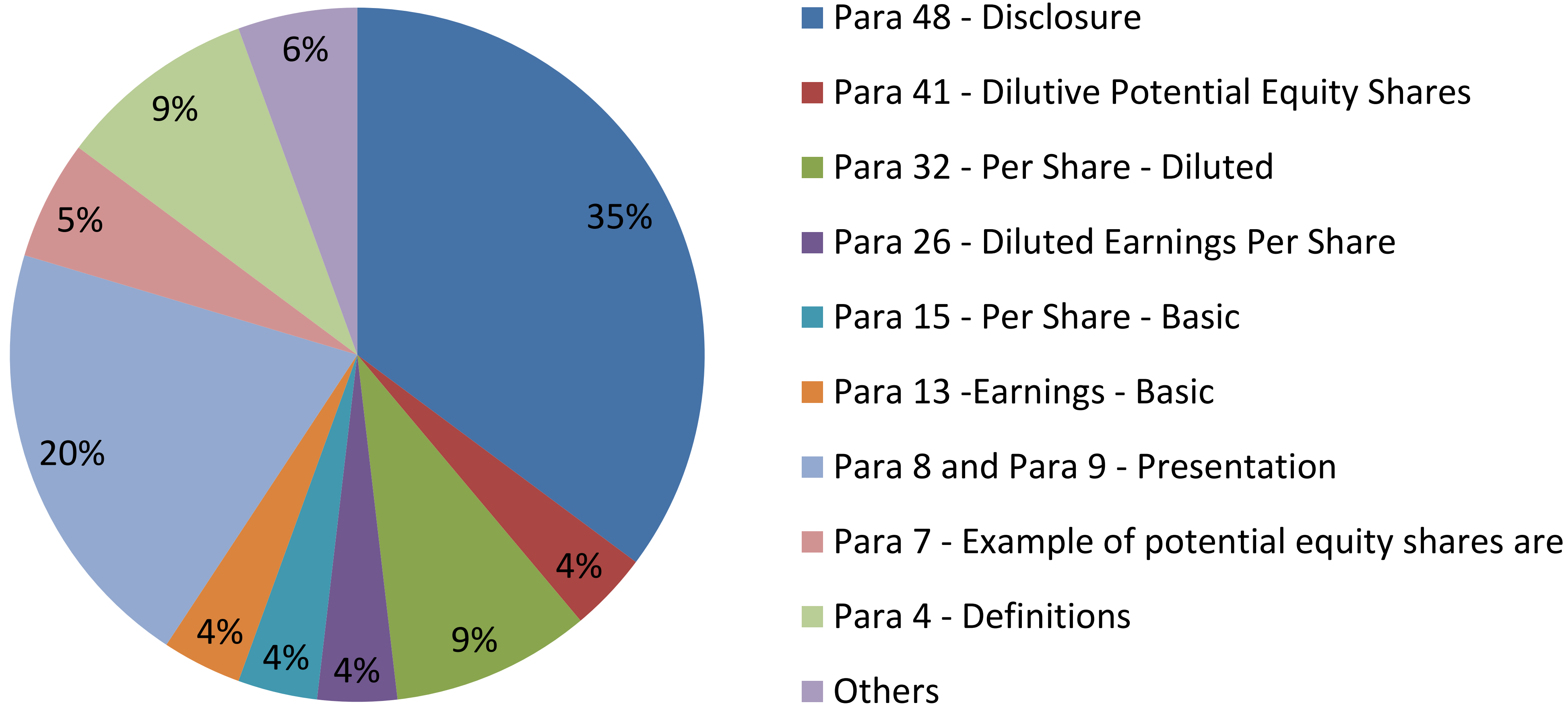
In the ‘Related Party Disclosures’ as given in the Annual Report of a company, **the list of related parties where control exists includes the name of an individual and the relationship has been stated as ‘Lessor’.**

It was viewed that an individual in the capacity of a lessor cannot exercise control or significant influence over the company. Accordingly, such description of relationship is not in line with the requirements of AS 18.

Non - Compliance of Accounting Standard

AS 20 - Earnings Per Share

Deficiencies observed : at a glance



Case:

From the Notes to Accounts given in the Annual Report of a company, it was noted that the diluted earnings per share has been stated to be as Not Applicable (NA).

Principle:

Paragraphs 26 and 41 of AS 20

Observation:

It appears that the company has stated Diluted EPS at NA either because there are no potential equity shares or the potential equity shares (if any) have an anti dilutive impact.

Considering the above stated paragraphs of AS 20, it was viewed that in absence of potential equity shares both the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period will remain same as that in case of basic EPS. Hence, **if a company has no potential equity shares then its diluted EPS would be the same as basic EPS. Further in case potential equity shares have an anti dilutive effect, then such potential equity shares are ignored for calculating diluted EPS which will also result in diluted EPS being equal to basic EPS. Accordingly, stating that Diluted EPS is Not Applicable is not correct** as per the above – stated requirements of AS 20.

Case:

From the financial statement of a company, it was noted that on the face of Statement of profit and loss as well as under notes to accounts, only 'earning per share' has been disclosed, without stating whether it is basic EPS or diluted EPS.

Principle:

Paragraph 8 of AS 20

Observation:

It was viewed that **even if there is no difference in the basic and diluted EPS, to comply with the requirement of AS 20, the basic as well as diluted EPS should be explicitly disclosed.** Merely stating 'earning per share' is not in compliance with the requirements of AS 20.

Case:

In the Statement of Profit and Loss as well as Notes to accounts, the nominal value of shares was not disclosed

Principle:

Paragraph 48 (ii) (c) of AS 20

Observation:

It was observed from the disclosure given in respect of earning per share **in the Statement of profit and loss read with the notes to accounts that although basis and diluted EPS was disclosed, however, the nominal value of shares as required by Paragraph 48 (ii) (c) of AS 20 was not disclosed.**

Case:

It was noted from the details given in the Annual Report of a Company that the number of equity shares outstanding has increased as on the current balance sheet date when compared with the last balance sheet date. It was further noted from Director's Report that shares have been issued during the year.

Principle:

Paragraph 15 of AS 20

Observation:

It was viewed that in the given case**, the weighted average number of shares would be different from the outstanding number of shares as there is an increase in the number of shares during the year.** However, for the purpose of calculating basic EPS, the number of equity shares outstanding as on the balance sheet date has been considered for its computation which is not in line with aforesaid requirement of paragraph 15 of AS 20.

Case:

Share application money received was disclosed in the Balance Sheet of a Company.

Principle:

Paragraph 28 and 32 of AS 20

Observation:

It was noted that share application money has been received during the year which indicates that potential equity shares exist as on the reporting date. However, **under note of 'Earnings per share' both basic earnings per share and diluted earnings per share have been disclosed at the same value which clearly indicates that the potential equity shares arising due to share application money pending allotment has not been considered for determining of diluted earnings per share.** It is against aforesaid requirements of AS 20.

Case:

In the Annual Report of a Company, both Basic and diluted EPS has been reported as NIL. It was further noted from the statement of Profit & Loss that company has incurred loss during the year.

Principle:

Paragraph 9 of AS 20

Observation:

It was viewed that aforesaid requirement **envisages the disclosure even for negative basic and diluted earnings per share. In the given case, it was noted that losses have accrued and hence during the year, the basic and diluted earnings per share have been reported at nil** which is incorrect.

Case:

In the Annual Report of some companies, it was observed that although Statement of Profit and Loss showed Extraordinary Items, the computation of basic and diluted earnings per share was made only with the profit after tax inclusive of the Extraordinary Items.

Principle:

Paragraph 48 (i) of AS 20

Observation:

It was noted from the Statement of Profit & Loss as well as note on the earnings per share that the company has computed the earnings per share on the basis of earnings including extraordinary items which is as per the requirement of paragraph 8 read with paragraph 12 of AS 20. However, **the Basic and Diluted EPS computed on the basis of earnings excluding extraordinary items have not been disclosed which is not in line with the requirements of paragraph 48(i) of AS20.**

Non - Compliance of Accounting Standard

AS 22 - Accounting for Taxes on Income

Case:

Certain companies do not disclose the break-up of the Deferred Tax Liability/ Deferred Tax Asset either in the schedule or notes to accounts.

Principle:

Para 31 of AS 22

Observation:

Para 31 of AS 22, Accounting for Taxes on Income, requires that " the break-up of deferred tax assets and deferred tax liabilities into major components of the respective balances should be disclosed in the notes to accounts."

Non disclosure of break-up of deferred tax assets or deferred tax liability is in contravention of AS 22.

Case:

The accounting policy relating to deferred tax states that "Deferred tax liability and asset are recognised, subject to the consideration of prudence, on timing differences using the tax rates substantively enacted on the Balance Sheet date."

Principle:

Para 15 of AS 22

Observation:

It has been noted from paragraph 15 of AS 22 that **deferred tax assets should be recognised and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realised.** It has been noted that although the deferred tax asset has been recognised, however, it is not clear as to whether there exists reasonable certainty that sufficient future taxable income would be available against which such deferred tax assets could be realised. Thus, the stated accounting policy with regard to recognition of Deferred Tax Assets is not complete.

Case:

A company had the carry forward of losses and its accounting policy with regard to Deferred tax , inter alia , states that "….The management is of the opinion that sufficient future taxable income will be available against which, such deferred tax assets will be realised……."

Principle:

Para 17 of AS 22

Observation:

Paragraph 17 of AS 22 requires that "where an enterprise has unabsorbed depreciation or carry forward of losses under tax laws, deferred tax assets should be recognised only to the extent that there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available against which such deferred tax assets can be realised". **It has been noted that the company had carried forward unabsorbed losses and as such Paragraph 17 was applicable. It was viewed that although the management was of opinion that the sufficient future taxable income will be available against which such deferred tax assets will be realised, however, it has failed to state that whether there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available. Accordingly, the stated accounting policy is not as per AS 22.**

Case:

The deferred tax assets and liabilities had been presented in either of the manner as given below:

- Deferred tax liability shown as a part of ‘Loan Funds’.
- Deferred tax (net) shown after the head ‘Net Current Assets’.
- Deferred tax Liability is shown as a deduction from the ‘Application of Funds’.
- Deferred tax Liability is shown as a part of ‘Shareholders Funds’.
- Deferred tax Liabilities is shown as distinct sub-head under the Schedule of Provisions.

Principle:

Paragraph 30 of AS 22

Observation:

Explanation to Paragraph 30 of AS 22 requires that **deferred tax liabilities should be disclosed on the face of the balance sheet separately after the head ‘Unsecured Loans’ and deferred tax assets should be disclosed on the face of the balance sheet separately after the head ‘Investments’.**

Accordingly, it was viewed that the aforesaid presentation of DTA/ DTL is not in line with AS 22.

Non - Compliance of Accounting Standard

AS 23 - Accounting for Investments in Associates in Consolidated Financial Statements

Case:

It was noted from the schedule of Related Party Disclosures that the Company has an associate company.

Observation:

It may be noted that Paragraph 23 of AS 23, requires that "Investments in associates accounted for using the equity method should be classified as long-term investments and disclosed separately in the consolidated balance sheet. The investor's share of the profits or losses of such investments should be disclosed separately in the consolidated statement of profit and loss. The investor's share of any extraordinary or prior period items should also be separately disclosed.

From the auditor's report, it was noted that the financial statements of associate company had not been included in the Consolidated Financial Statements. Further, it was noted that neither the investors' share of the profits or losses in such associate company had been separately disclosed in the Consolidated Statement of Profit & Loss nor the auditors' report provide any reference on the same. Accordingly, it was viewed that the requirement of AS 23 had not been strictly complied with.

Non - Compliance of Accounting Standard

AS 24 – Discontinuing Operations

Case:

From the Annual Report of a company it has been noted that the Explanatory statements pursuant to section 173(2) of the Companies Act, 1956, states as follows:

"As you are aware that you exited the business of manufacturing fertilizers and has taken up real estate activities with the consent of shareholders…"

Principle:

Paragraph 20 and 32 of AS 24

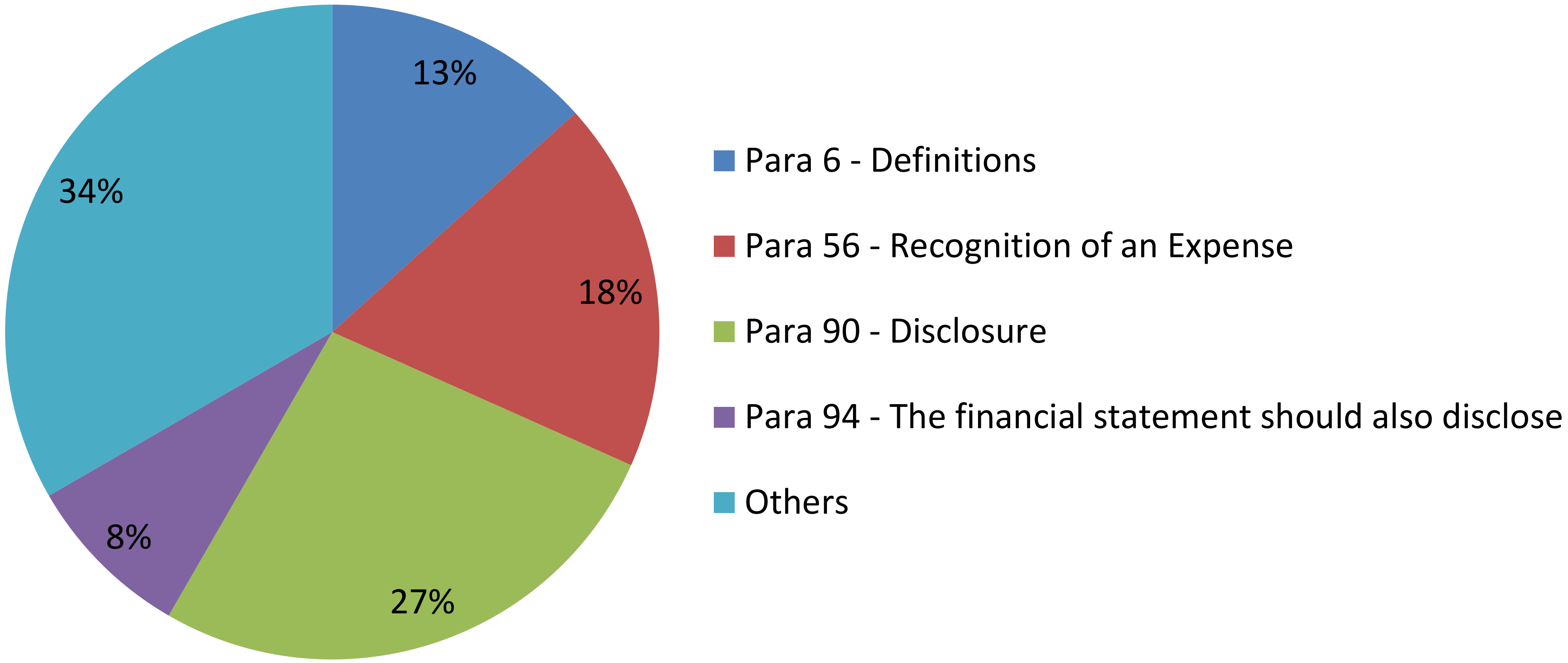
Observation:

It has been noted from Explanatory statements pursuant to section 173(2) of the Companies Act, 1956, that **the company has discontinued the business of manufacturing fertilizers and has taken up real estate activities. However, it has failed to disclose the information as required by Paragraph 20 and 32 of AS 24, Discontinuing Operations.**

Non - Compliance of Accounting Standard

AS 26 – Intangible Assets

Deficiencies observed : at a glance



Case:

From the accounting policy on 'Deferred Revenue Expenditure' given in the Annual Report of a company it was noted that expenditure incurred on factory license fees, trade mark fee, seed marketing expenses, public/capital issue expenses, preliminary expenses and rental paid for pre-commencement of retail stores, factories has been treated as deferred revenue expenditure which are being amortised over the life of the concerned items.

Principle:

Paragraph 6.2 of AS 26

Observation:

It was viewed that the expenditure incurred on **rental paid for pre-commencement of retail stores, factories, seed marketing expenses, public/ capital issue expenses, preliminary expenses cannot be considered to be a 'resource' being controlled by the enterprise and hence, such expenses do not meet the criteria of the term 'asset' and therefore, they cannot be treated as asset.**

Accordingly, any such expenditure incurred after 1-4-2006 i.e. after AS 26 become mandatory should be expensed as and when it is incurred.

With regard to factory license fees, trade mark fees, it was viewed that these expenditure gives rise to intangible assets. Accordingly, they should be disclosed under the head of ‘intangible assets’ rather than ‘deferred revenue expenditure’.

With regard to software development expense and product development expense, it was viewed that if it meets the definition of asset as stated in paragraph 6.2 of AS 26, the same should also be recognised as an ‘intangible asset’, otherwise it should be expensed in the Statement of Profit and Loss in the year in which the expenditure is incurred.

Case:

It was noted from the accounting policy on Intangible Assets of a company that Technical know-how is amortised over the useful life of the underlying plant and amortisation is done on straight line basis.

Principle:

Paragraph 94 of AS 26

Observation:

It was noted that Technical know-how is amortized over the useful life of the underlying plant and the useful life of technical know-how has not been considered for determination of its amortisation period, which is an important element to determine its amortisation policy as explained in paragraph 69 of AS 26. It was viewed that intangible assets should be amortised over its useful life or the life of underlying assets or over the period of 10 years, whichever is earlier. In case if it is more than 10 years, then the reason should be disclosed for determining the useful life higher than 10 years as per paragraph 94 of AS 26.

Hence, it was viewed that the stated policy adopted for the technical know-how is not in line with the requirements of AS 26.

Case:

The accounting policy on Intangible Assets stated by a company is as follows: "Cost of Right of Way for laying pipelines is capitalised as Intangible Asset and being perpetual in nature, is not amortised".

Principle:

AS 26 and EAC opinion on Query No 3 of Volume 33

Observation:

It was noted that the cost of right of way is capitalised as intangible item but is not being amortized considering it to be perpetual in nature. **It was viewed that as per AS 26, the useful life of the right of way may be very long but it is not infinite, accordingly, the depreciable amount should be allocated on a systematic basis over the best estimate of its useful life which can be determined based on technical, legal and economic factors.** Accordingly, it was viewed that non- amortisation of the cost of right of way is not in line with AS 26. This view is also supported by EAC opinion on Query No 3 of Volume 33 published in 'The Chartered Accountants', September 2013.

Case:

From the accounting policy relating to intangible assets of a company, it was noted that the Franchise Rights were disclosed to continue in perpetuity. However, the useful life was determined as 25 years based on the expected term that franchise would continue to contribute to the net cash inflows of the company.

Observation:

The company has stated that the franchise rights will continue in perpetuity, however, it has estimated the useful life of the franchise rights as 25 years. It was, further, observed from the franchisee agreement that the period of the said agreement will continue in perpetuity. The terms of the purchase agreement also provide for additional consideration which will be payable after completion of 10 years i.e. 20XX onwards for an amount which will be equal to 20% of the franchisee income received in respect of those years.

It was viewed that if the enterprise was of the view that it would be able to exercise such rights for 25 years, and therefore, it has adopted an accounting policy of amortizing such rights over a period of 25 years, **it should also estimate the amount of additional fees that would be payable by it for such rights and, accordingly, the total cost of such rights should be capitalised and amortized.**

However, in the given case, it was noted that it has **neither included the consideration payable over the period of 10 years in the cost of franchisee rights nor has it disclosed the amount of commitments payable against such franchisee rights for the additional 15 years.** Thus, the treatment of franchisee fees as adopted by the enterprise is not in line with the requirements of AS 26.

Case:

It was noted from the Balance Sheet of a company that the Miscellaneous Expenditure (to the extent not written off or adjusted) as at 31st March, 20XX was the same as in the immediately preceding year.

Principle:

Paragraph 99 of AS 26

Observation:

The balances of the miscellaneous expenditure for the current and previous financial years, indicates that the said expenditure has not been amortised during the financial year under review. Further, it was noted that neither the amortisation policy nor the information regarding miscellaneous expenditure (viz. nature of such expense, year of incurrence) has been disclosed in the financial statements.

In the absence of such information, it could not be ascertained as to whether the said miscellaneous expenditure was incurred before 1.4.2004 or after 1.4.2004. **It was viewed that in case, it was incurred before 1.4.2004, it should be amortised as per original accounting policy of the company, provided the total period of amortisation does not exceed ten years, otherwise it should have been expensed as and when incurred.** However, non- amortisation of such expenses during the year indicates that the accounting treatment adopted by the company is not in line with the requirements of paragraph 99 of AS 26.

Case:

The accounting policy of fixed assets given in the Annual Report of a company read as follows:
‘Intangible assets are identified when they are expected to provide future enduring economic benefits. The assets are identified in the year in which the relevant asset is put to use. (emphasis added)’

Observation:

As per aforesaid principle, internally generated asset can be capitalised and the capitalised cost, comprises expenditure that are directly attributable for making the asset ready for its intended use. However, in the given case the intangible assets are identified in the year in which the relevant asset is put to use. It was viewed that this is not in line with requirement of AS 26 which requires recognition with reference to the date **when an intangible asset is available for use rather than when it is put to use.**

Case:

It was noted from the accounting policy on Research & Development of a company that the expenditure on proposed projects has been accumulated and it is amortized over a period of 5 years. It was further noted from the accounting policy that the expenditure on software development, product development, product testing, etc. has been charged to the Statement of Profit & Loss.

Principle:

Paragraph 44 of AS 26

Observation:

AS 26 requires classification of expenses incurred on Research and Development activities phase-wised i.e. those which have been incurred during research phase are classified as 'Research Expenditure' and those which have been incurred during development phase be classified as 'Development Expenditure'. The expenditure incurred during the phase should be recognised as an expense in the Statement of Profit & Loss immediately, and expenditure which have been incurred during the development phase should be recognised as an Intangible Asset, if the recognition criteria given in paragraph 44 of AS 26 are satisfied. Accordingly, it was viewed that Research & Development expenditure that meets the criteria of paragraph 44 of AS 26 should be recognised as an 'intangible assets'.

However, in the given case, **Research and Development expenditures have not been classified between research phase and development phase** as required by AS 26. Further, the stated policy indicates that R&D expenditures **have been treated as 'deferred revenue expenditure'** which is again contrary to AS 26 .

Non - Compliance of Accounting Standard

AS 27 – Financial Reporting of Interests in Joint Ventures

Case:

From the Related Party Disclosures of a company, it has been that the company has a joint venture with A Ltd.

Principle:

Paragraph 53 of AS 27

Observation:

As per Paragraph 53 of AS 27, a venturer should disclose a list of all joint ventures and description of interest in significant joint ventures.

It was noted that although there exists a relationship in the nature of joint venture but the company omits to provide the description of interest in such joint venture, which is against the requirement of paragraph 53 of AS 27.

Thank You