KPMG

First Notes

FRRB issued its observations on compliance with financial reporting requirements by listed and other companies

8 May 2018

First Notes on

Financial reporting

Corporate law updates

Regulatory and other information

Disclosures

Sector

All

Banking and insurance

Information, communication, entertainment

Consumer and industrial markets

Infrastructure and government

Relevant to

All

Audit committee

CFO

Others

Transition

Immediately

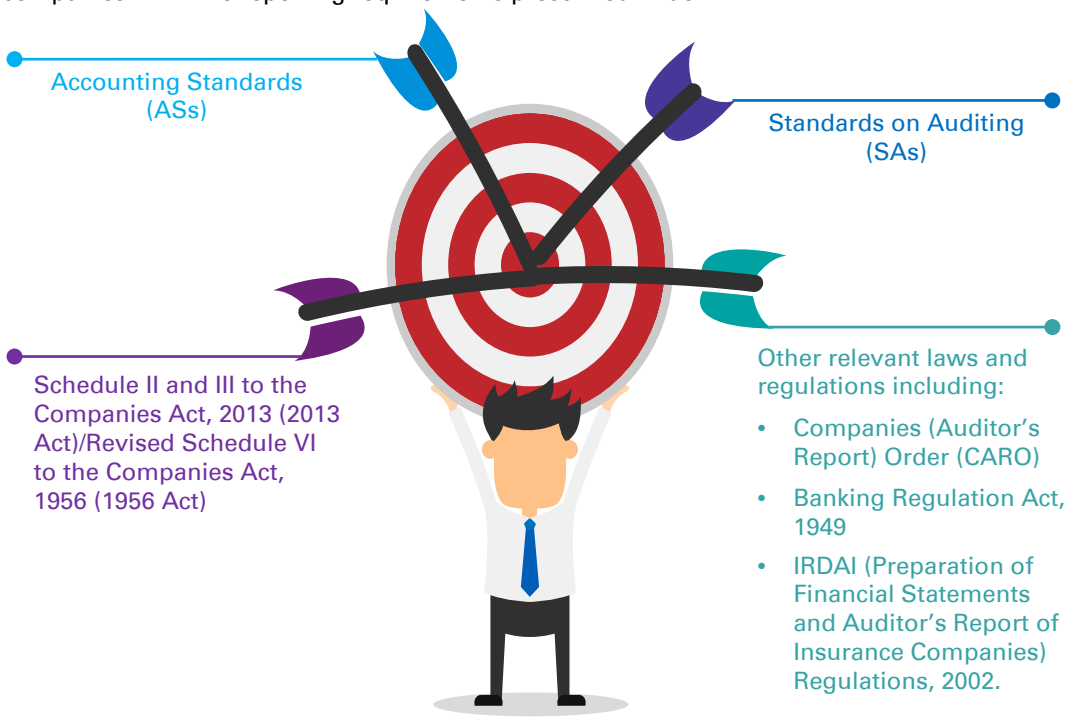
Within the next three months

Post three months but within six months

Post six months

Forthcoming requirement

Recently, the Financial Reporting Review Board (FRRB) of the Institute of Chartered Accountants of India (ICAI)[1], issued its third volume of 'Study on Compliances of Financial Reporting Requirements' (the study). The study[2] highlights instances of non-compliances by certain companies[3] with the reporting requirements prescribed under:



This issue of First Notes provides an overview of key observations of the FRRB with respect to AS and Schedule II and III to the 2013 Act as provided in its study.

[1]The FRRB was formed by the ICAI in the year 2002 to review the general financial statements and auditor's report thereon of certain companies and ensure compliance with the prescribed reporting requirements under the relevant statute governing the company.

[2]Observations finalised between March 2011 and January 2017 have been considered.

[3]Financial statements and the auditor's report thereon could be selected suo motto by FRRB or on a reference made to it by any regulatory body such as the Reserve Bank of India (RBI), the Securities and Exchange Board of India (SEBI), etc. The FRRB may also review general purpose financial statements and the auditor's report thereon relating to which serious accounting irregularities have been highlighted by the media reports.

Summary of key observations of FRRB

Compliance with AS

AS 1, *Disclosure of Accounting Policies*

- Failure to disclose significant accounting policies adopted in the preparation and presentation of financial statements such as revenue recognition, borrowing costs, inventories, impairment of assets, goodwill and subsidies granted by the government.
- Gain on outstanding derivative contract has been recognised in the statement of profit and loss which is against the principle of prudence as given in AS 1 (i.e. in view of the uncertainty attached to future events, profits are not anticipated but recognised only when realised though not necessarily in cash). In this case, the company did not state whether it has adopted AS 30, *Financial Instruments: Recognition and Measurement*, AS 31, *Financial Instruments: Presentation* and AS 32, *Financial Instruments: Disclosures*.

AS 2, *Valuation of Inventories*

- Failure to disclose the cost formula adopted for determining the cost of inventories. In certain cases, where the company has various classes of inventories, the formula for valuation of each class has not been identified and in certain cases, the cost formula has not been correctly applied (e.g. use of average cost instead of weighted average cost).

AS 3, *Cash Flow Statements*

- A cash flow statement has not been prepared by a certain subsidiary of a listed company and also by a certain company which is in the process of listing (on the ground of being a small and medium sized company), when such companies are not exempt from preparation of cash flow statement under AS 3[4].

AS 12, *Accounting for Government Grants*

- Capital investment subsidy which is in the nature of promoter's contribution has been credited to the statement of profit and loss instead of capital reserve.

AS 14, *Accounting for Amalgamations*

- Systematic basis of amortising goodwill on amalgamation has not been followed.
- There is a failure to comply with the disclosure requirements of AS 14 in few cases. For instance, the missing disclosures are, general nature of business of the amalgamating company, percentage of each company's equity shares exchanged and the accounting treatment of the difference between the consideration and the value of net assets acquired.

AS 16, *Borrowing Costs*

- In certain cases, cost of derivative transactions has been added to the cost of borrowings. Such cost does not qualify to be a borrowing cost as it is neither an ancillary cost incurred in connection with the arrangement of borrowings nor it is an exchange difference arising on the amount of principal of the foreign currency borrowings.

AS 17, *Segment Reporting*

- In certain cases, disclosure of the fact that there is only one business or geographical segment has not been made. Merely reporting that 'segment reporting as per AS 17 is not applicable' is not a sufficient disclosure as per AS 17.
- In certain cases, amount of segment assets and segment liabilities do not match with the aggregate assets and liabilities as given in the balance sheet. A reconciliation has not been given to explain the difference in figures.

[4]AS 3 is not mandatory for small and medium sized companies. A small and medium sized company means a company:

a) Whose equity or debt securities are not listed or are not in the process of listing on any stock exchange whether in India or outside India
b) Which is not a bank, financial institution or an insurance company
c) Whose turnover (excluding other income) does not exceed INR50 crore in the immediately preceding accounting year
d) Which does not have borrowing (including public deposits) in excess of INR10 crore at any time during the immediately preceding accounting year and
e) Which is not a holding or subsidiary company of a company which is not a small and medium sized company.

AS 18, *Related Party Disclosures*

- In certain cases, there is a failure to disclose corporate guarantees given to banks/financial institutions for credit facilities extended to the subsidiaries and/or personal guarantees given by the directors for loans taken from banks/financial institutions as related party transactions.

AS 20, *Earnings Per Share (EPS)*

- Failure to disclose negative basic and diluted EPS (i.e. loss per share) on the face of the statement of profit and loss.

AS 21, *Consolidated Financial Statements (CFS)*

- Fact that different policies have been adopted for subsidiaries (vis-à-vis parent) have been mentioned. However, companies have not mentioned proportion of the items in the CFS to which these different accounting policies have been applied. Additionally, such companies did not disclose the fact that it is not practicable to follow uniform accounting policies.

AS 24, *Discontinuing Operations*

- Failure to disclose the information relating to net cash flows attributable to the operating, financing and investing activities of the discontinuing operations during the reported period.

AS 26, *Intangible Assets*

- Failure to classify research and development expenditures between research and development phase.

AS 28, *Impairment of Assets*

- Net selling price for the purpose of impairment loss has been determined on the basis of expected salvage value (i.e. estimated value that an asset will realise upon its sale at the end of its useful life) rather than on the basis of value obtained as on the balance sheet date (which cannot be considered to be an end of the useful life of an asset, unless the assets would not be in use after the reporting date).

Compliance with Schedule II and III to the 2013 Act

With respect to compliance with Schedule II and III to the 2013 Act, some of the discrepancies highlighted by FRRB are as follows:

Statement	FRRB observations
Balance sheet and related notes	• Expenses on acquisition of intellectual property rights and licences for projects under development have been classified as capital work-in-progress instead of intangible assets under development. • Operating cycle of assets and liabilities has been determined on the basis of duration of each contract instead of determining it for the company as a whole. • Advances given to government authorities classified on the basis of amount held with different authorities instead of disclosing them as per their nature such as income tax, etc.
Statement of profit and loss and related notes	• Bank and other finance charges which are in the nature of 'other borrowing costs' have been classified as 'interest expense'. This is not in line with the requirements of Schedule VI to the 1956 Act. • Exchange differences on foreign currency transactions and translation have been included in the cost of raw material consumed instead of presenting them separately. • Profit on slump sale (being an exceptional item) has been adjusted before charging off depreciation cost and finance cost. This presentation is not in line with the requirements of Schedule VI to the 1956 Act.
Others	• Balance of securities premium account has been utilised for writing off exchange differences on share/debenture issue expenses and premium payable on their redemption in contravention of provisions of Section 52 of the 2013 Act/Section 78(2) of the 1956 Act.

(Source: KPMG in India's analysis, 2018 based on the observations made by FRRB in its study)

Others

The FRRB has also highlighted certain discrepancies with respect to financial statements of banks (particularly, Non-Banking Financial Companies (NBFCs)) and insurance companies. These are as follows:

Banks (including NBFCs)

- Failure to disclose the following particulars by a NBFC classified as non-deposit taking asset financing company:
  a) Capital to risk asset ratio
  b) Exposure to real estate sector, both direct and indirect and
  c) Maturity pattern of assets and liabilities.
- Failure to disclose the provisioning coverage ratio (ratio of provisioning to gross non-performing assets) in the notes to accounts to the balance sheet.
- In certain cases, banks have not classified borrowings into following categories:
  a) Borrowings in India
  b) Borrowings outside India.

  Further, borrowings should be sub-classified depending on their source e.g. perpetual tier-I bonds, subordinated debts, etc.

Insurance companies

- Failure to separately disclose amount of investments held in money market instruments such as government securities or bonds including treasury bills as investing activities in the cash flow statement.

Our comments

The FRRB study has important areas to be considered while preparing and presenting the financial statements of companies. Similar observations were raised by the Quality Review Board (QRB) in its report dated 10 November 2017.

This implies that there is an urgent need for companies to evaluate whether the financial statements have been prepared in accordance with the prescribed accounting framework and are providing adequate disclosures.

It is important to note that in case of listed companies, the FRRB is required to comment on whether the modified opinion in an auditor's report is justified or not. Therefore, based on the opinion of FRRB, listed companies may be required to rectify its modified opinion and/or submit the revised pro-forma financial results in the manner prescribed in the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

The bottom line

Though the review by FRRB relates to AS and not Ind AS, some of the observations are equally relevant for Ind AS users.

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KPMG in India's IFRS institute

Visit KPMG in India's IFRS institute - a web-based platform, which seeks to act as a wide-ranging site for information and updates on IFRS implementation in India.

The website provides information and resources to help board and audit committee members, executives, management, stakeholders and government representatives gain insight and access to thought leadership publications that are based on the evolving global financial reporting framework.

Ind AS Transition Facilitation Group (ITFG) issues Clarifications Bulletin 15

18 April 2018

The Ind AS Transition Facilitation Group (ITFG) in its meeting considered certain issues received from the members of the Institute of Chartered Accountants of India (ICAI), and issued its Clarifications' Bulletin 15 on 5 April 2018 to provide clarifications on 10 application issues relating to Indian Accounting Standards (Ind AS).

This issue of IFRS Notes provides an overview of the clarifications issued by ITFG through its Bulletin 15.

Missed an issue of Accounting and Auditing Update or First Notes

Issue no. 21 – April 2018

The topics covered in this issue are:

- Ind AS 115 - Impact on the pharmaceutical sector
- Accounting for instruments held as regulatory capital by banks
- Enhanced focus on other information in auditor reporting
- Frequently asked questions on business combinations
- Regulatory updates.

SEBI decisions regarding the Report of the Committee on Corporate Governance

20 April 2018

On 28 March 2018, the Securities and Exchange Board of India (SEBI) considered the recommendations of the Kotak Committee on Corporate Governance (the Committee) and the public comments thereon. Accordingly, they accepted certain recommendations without modifications, few with modifications and referred certain recommendations to various agencies (i.e. government, other regulators, professional bodies, etc.) since the matters involved those agencies.

In this issue of First Notes, we have provided an overview of the decisions considered by SEBI.

Voices on Reporting

KPMG in India is pleased to present Voices on Reporting – a series of knowledge sharing calls to discuss current and emerging issues relating to financial reporting.

A special session has been scheduled on 10 May 2018 (04:00 – 05:00 PM) to discuss the broad framework of Integrated Reporting (IR) and its voluntary adoption by listed companies in India.

For registration details, please click here.

Feedback/queries can be sent to aaupdate@kpmg.com

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