National Conference on Accounting Standards

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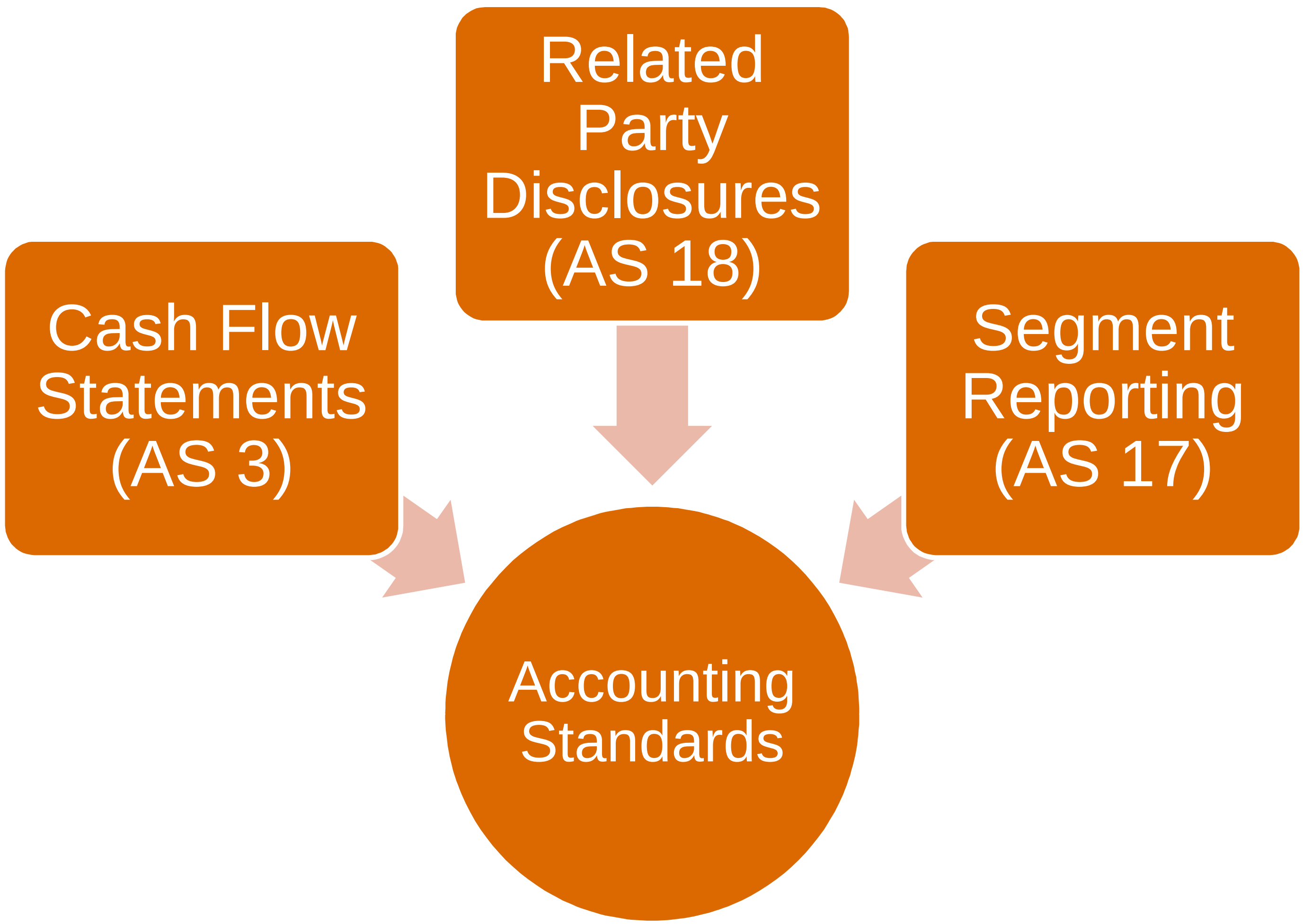
Agenda



Related Party Disclosures (AS 18)
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Accounting Standard (AS) - 3

Cash Flow Statements

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- **Introduction**
- **Classification**
- **Treatment of Special Incidences**
- **Disclosures of Cash and Cash equivalents**
- **Common Errors**
- **FRRB Observations**

Introduction

- Cash flow statement is additional information to user of financial statement
- This statement exhibits the flow of incoming and outgoing cash
- This statement assesses the ability of the enterprise to generate cash and cash equivalents
- It also assesses the needs of the enterprise to utilise the cash and cash equivalents generated
- It also assesses the liquidity and solvency of the enterprise.

Cash and Cash Equivalents

- Cash Equivalents
  - Held for meeting short term commitments
  - It is readily convertible into known amounts of cash
  - It has a very insignificant risk
  - Short maturity (say 3 months maximum)

Operating Activities

These are principal revenue producing activities of the enterprise.

Examples:

Cash receipts from sale of goods / rendering services;

Cash receipts from royalties, fees, commissions and other revenue;

Cash payments to suppliers of goods and service;

Cash payments to and on behalf of employees

Investing Activities

The activities of acquisition and disposal of long term assets and other investments not included in cash equivalent are investing activities

It includes making and collecting loans, acquiring and disposal of debt and equity instruments, property and fixed assets etc.

Examples:

Cash payments to acquire fixed assets

Cash receipts from disposal of fixed assets

Cash payments to acquire shares, warrants or debt instruments of other enterprises and interest in joint ventures

Cash receipt from disposal of above investments

Financing Activities

Those activities that result in changes in size and composition of owners capital and borrowings of the organization

It includes receipts from issuing shares, debentures, bonds, borrowing and payment of borrowed amount, loan etc.

- Sale of share
- Buy back of shares
- Redemption of preference shares
- Issue / redemption of debentures
- Long term loan / payment thereof
- Dividend / interest paid

Methods of Calculation

Cash Flows from Operating Activities can be derived by two methods

Direct

- In this method, gross receipts and gross payments of cash are disclosed.

Indirect

- In this method, profit and loss account is adjusted for the effects of transaction of non-cash nature.

Special Incidences

Foreign Currency Transactions

- The effect of change in exchange rate in cash and cash equivalents held in foreign currency should be reported as separate part of the reconciliation of cash and cash equivalents.
- Unrealized gain and losses arising from changes in foreign exchanges rates are not cash flows.

Tax

- Cash flow for tax payments / refund should be classified as cash flow from operating activities.
- If cash flow can be specifically identified as cash flow from investment / financing activities, appropriate classification should be made.

Disclosure of Cash and Cash Equivalents

The components of cash and cash equivalents should be disclosed

Reconciliation of the amount in the cash flow statement with the equivalent items reported in the balance sheet

The amount of cash and cash equivalent balance held by the enterprises that are not available for use (with explanation by management)

Common Errors

Item/ Transaction	Observation ✗	Requirement	What should one Remember ✓
Non Cash Adjustment	Export incentives accrued disclosed as a non-adjusting event in arriving at Operating Profit before working capital changes	Under the indirect method, the net cash flow from operating activities is determined by adjusting net profit or loss for the effects of: a) changes during the period in inventories and operating receivables and payables; (b) Noncash items such as depreciation, provisions, deferred taxes, and unrealized foreign exchange gains and losses; and (c) all other items for which the cash effects are investing or financing cash flows	Ensure that the non-cash adjustments made to operating profit are appropriate

Common Errors

Item/ Transaction	Observation	Requirement	What should one Remember
Dividend Distribution Tax	No specific mention of Dividend distribution tax although the cash flows from financing activities includes dividend paid	Dividends paid are to be disclosed as cash flows from financing activities. It follows that tax on dividend should also be disclosed along with the dividends paid.	Ensure that tax on dividend is disclosed separately under cash flows from financing activities
Cash and cash equivalents not available for use	In some cases, where the company has certain cash and cash equivalents which are subject to certain restrictions (e.g.., deposits for margin money), such fact is not mentioned in the cash flow Statement	An enterprise should disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the enterprise that are not available for use by it.	Ensure that where there restrictions on usage of cash and cash equivalents, this fact is disclosed in the cash flow statement as a note

Common Errors

Item/ Transaction	Observation	Requirement as per Standard	What should one Remember
Reporting cash flows on a net basis	It has been observed that in several cases, proceeds and repayment of term loans, etc are disclosed on a net basis.	Cash flows arising from the following operating, investing or financing activities may be reported on a net basis: (a) cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the enterprise; and (b) cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short.	Disclosures to be made on a gross basis in such cases.

FRRB Observations

Cash Flow Statement of non-financial enterprises, interest received has been shown as cash flow from financing activities. This is not as per Accounting Standard (AS) 3, Paragraph 30 which requires that interest received to be shown as cash flow from investing activities.(CA Journal Feb 2006)

Cash Flow Statement of non-financial enterprises, interest paid has been shown as cash flow from operating activities. This is not as per Accounting Standard (AS) 3, Paragraph 30 of AS 3 which requires that interest paid to be shown as cash flow from financing activities. (CA Journal, Feb 2006)

Certain companies which 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'. Tax on dividend paid (corporate dividend tax) is related to distribution of profits. The *Guidance Note on Accounting for Corporate Dividend Tax requires the corporate dividend tax to* be disclosed along with the dividend paid in the profit and loss account, 'below the line' applying the same principle, tax on dividend paid (corporate dividend tax) should be shown along with the dividend paid in the Cash Flow Statement under the heading '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'. (CA Journal, March 2007)

Accounting Standard (AS) - 18

Related Party Disclosures

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- Scope
- Who are Related Parties
- Disclosure Requirements
- Common Errors
- FRRB Observations

Scope

Should be applied in reporting related party relationships and transactions between a reporting enterprise and its related parties.

The requirements of this Statement apply to the financial statements of each reporting enterprise as also to consolidated financial statements presented by a holding company

Who are Related Parties ?

- Holding, Subsidiary, Sub-Subsidiary, Fellow Subsidiary

- Joint Ventures and Associates of reporting enterprises
  - In a joint venture, there has to be a contract to carry out a economic activity with a joint control.
  - An Associate is an enterprise in which an investing party has significant influence and which is neither a subsidiary nor a joint venture of that party.

- Individuals or their relatives having control or significant influence on such reporting enterprises.

Who are Related Parties ? (Contd.)

  - Significant Influence means participation in the financial or operating policy decision of an enterprise, but not control of these policies.
  - Control exists when an individual holds more than 50% stake in the reporting enterprise.

- Key Management personnel and relatives of such personnel.
  - Those are who have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise.
- Enterprises over which any person described above is able to exercise significant influence.

Disclosure Requirement (Para 23)

- If there have been transactions between related parties, during the existence of a related party relationship, the reporting enterprise should disclose the following:

(i) the name of the transacting related party;

(ii) a description of the relationship between the parties;

(iii) a description of the nature of transactions;

(iv) volume of the transactions either as an amount or as an appropriate proportion;

(v) any other elements of the related party transactions necessary for an understanding of the financial statements;

(vi) the amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date; and

(vii) amounts written off or written back in the period in respect of debts due from or to related parties.

Common Errors

Item/ Transaction	Observation	Requirement	What should one Remember
Disclosing the names of related parties.	Under the names of 'relatives of Key Managerial Personnel', only 'Others' has been disclosed with no individual names.	With respect to related parties, among other things, AS 18 requires the disclosures of the following where there have been transactions during the existence of a related party Relationship, as per paragraph 23: (i) the name of the transacting related party; (ii) a description of the relationship between the parties;	Ensure that all the names of related parties with whom there were transactions during the year are disclosed.

FRRB Observations

CA Journal January 2009

- ASI 23 'Remuneration Paid to Key Management Personnel – Whether a related party transaction' (Re: AS – 18 'Related Party Disclosures') requires that since key management personnel are related parties as per the provisions of AS 18, remuneration paid to key management personnel is a related party transaction requiring disclosures under AS 18. Some enterprises do not disclose Remuneration to key management personnel in related party disclosure as required by ASI-23,which is not as per the requirements of ASI-23. It may be noted that as per explanation to paragraph 14, non executive directors are not Key Management Personnel; therefore, any remuneration paid to them cannot be considered as Related Party Transaction

CA Journal Jan 2013

- AS 18 does not prescribe for classification of transactions with related parties as significant/insignificant or material/immaterial transactions. It is also felt that all transactions with related parties must be disclosed rather than just disclosing the significant transactions.

FRRB Observations (Contd)

CA Journal Jan 2013

It may be noted that as per paragraph 27 of AS 18, Related Party Disclosures, items of a similar nature may be disclosed in aggregate by type of related party; however, this should not be done in such a way as to obscure the importance of significant transactions and further explanation to the paragraph states that materiality primarily depends on the facts and circumstances of each case. Ordinarily, a related party transaction the amount of which is in excess of 10% of the total related party transactions of the same type (such as purchase of goods), is considered material, unless on the basis of the facts and circumstances of the case it can be concluded that even a transaction of less than 10% is material. As regards the nature of the transaction, ordinarily the related party transactions which are not entered into in the normal course of the business of the reporting enterprise are considered material subject to the facts and circumstances of the case. **Hence, it was viewed, that if any transaction with an individual party constitutes 10% of the total related party transactions of the same nature, then it shall be treated as material transaction with an individual party and, accordingly, the party-wise disclosure of the said transaction should be made in the Related Party disclosure**.

FRRB Observations(Contd)

CA Journal January 2013

- Although certain transactions are reported under the Related Party disclosures, some enterprises omit to provide the values of those transactions and the outstanding balance, if any, with the concerned parties. It has been felt that this is contrary to paragraphs 23 (iv) and (vi) of AS 18, Related Party Disclosures, which, requires the **volume of the transactions either as an amount or as an appropriate proportion as well as the amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date to be disclosed**.

CA Journal Jan 2013

- It may be noted that paragraph 21 of AS 18, Related party Disclosure, requires that the name of the related party and the nature of the **related party relationship where control exists should be disclosed, irrespective of whether or not there have been transactions between the related parties.** Following non-compliances have been commonly noted from review of the Related Party disclosures of various enterprises: a) In some cases, the names of related parties have been disclosed but the nature of the relationship with them has not been disclosed.
  b)In other cases, the names and the nature of only those related parties have been disclosed with whom transactions have taken place during the year.

Accounting Standard (AS) - 17

Segment Reporting

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- Definitions
- Types of segments
- Identification of reportable segment
- Disclosure
- FRRB Observations

Definitions

Reportable Segment

- Its is a business or geographical segment identified, for which segment information is required to be disclosed by the financial statements.

Business Segment

- Distinguishable component of the enterprise that provides an individual product/ service or a group of related product/service and is subject to risks and returns which are different from those of other segments.
- Factors which would be considered in determining whether products or services are related includes:
- Nature of products or services
- Nature of production process
- The methods used to distribute the products or provide the services
- Nature of regulatory environment

Definitions (Contd.)

Geographical Segment

- Is a distinguishable component of an enterprise which is engaged in providing products and services with in a particular economic environment and it is subject to risks and returns that are different from those of other segments operating in other economic environment. It includes:
  a) Similarity of economic & political conditions
  b) Relationship between operations
  c) Proximity of operations
  d) Special risks
  e) Exchange control regulations
  f) Underlying currency risks
- It can be based on:
  a)Location of Customer
  b)Location of asset

Types of segment

- Whether segmentation should be primarily product wise or geographical wise *depends on whether the primary risk is due to product or services or due to geographical area.*

- To identify primary risk, the internal organization and management structure and its system of reporting to the Board of directors (BOD) or Chief Decision Maker (CDM) of the Company should be considered.

Identification of reportable segment (Para 27, 28, 29)

- **Para 27a**: Total revenue (External+ intersegment) of a segment is 10% or more of total revenue of all segment, then that segment is reportable.
- **Para 27b**: Profit and loss of a segment is 10% or more of the combined profit/loss of all segments in absolute terms, then that segment is reportable.
- **Para 27c**: If assets of any segment is 10% or more than the total assets of all segments, then that segment is reportable.
- **Para 28**: Management may designate any segment as reportable even if it doesn't satisfy above mentioned criteria
- **Para 29**: It total external revenue of reportable segments identified as per Para 27 and 28 is less than 75% of total enterprise revenue, additional segments should be identified as reportable till limit of 75% is reached.

Identification of reportable segment (Contd)- Example

QUESTION:

Particulars	A	B	C	D	E	F	G	H	Total Segment	Enterprise as a whole
I) Segment Revenue										
External	0	255	15	10	15	50	20	35	400	
Intersegment	100	60	30	5	0	0	5	0	200	
Total	100	315	45	15	15	50	25	35	600	400
II) Segment Result										
Profit/ (loss)	10	(180)	30	(10)	16	(10)	10	14		(120)
III) Segment assets	30	94	10	22	6	10	10	18		200

Para 27a: Total revenue (External+ intersegment) of a segment is 10% or more of total revenue of all segment, then that segment is reportable

Particulars	A	B	C	D	E	F	G	H
% of total revenue i.e. 600	16.67	52.5	7.5	2.5	2.5	8.33	4.17	5.83

Therefore segment A and B are reportable.

Para 27b: Profit and loss of a segment is 10% or more of the combined profit/loss of all segments in absolute terms, then that segment is reportable.

Particulars	A	B	C	D	E	F	G	H	Total
Profit	10	0	30	0	16	0	10	14	80
Loss	0	180	0	10	0	10	0	0	200
% of total loss i.e. 200	5	90	15	5	8	5	5	7	

Therefore segment B and C are reportable.

Para 27c: If assets of any segment is 10% or more than the total assets of all segments, then that segment is reportable

Particulars	A	B	C	D	E	F	G	H
% of total assets i.e. 200	15	47	5	11	3	5	5	9

Therefore segment B and D are reportable.

Para 28: Management may designate any segment as reportable even if it doesn't satisfy above mentioned criteria:

Let segment E be selected as reportable

Para 29: It total external revenue of reportable segments identified as per Para 27 and 28 is less than 75% of total enterprise revenue, additional segments should be identified as reportable till limit of 75% is reached

As per Para 27 and 28, segments A,B,C,D and E is reportable. The total external revenue of these segments is 73.75% of the total revenue of the company. Therefore to meet the 75% requirement, additional segments have to be disclosed.

Let segment F be selected as reportable.

Disclosure requirements- Primary Segment information

- For each primary segment, the following disclosures have to be made:

  a) Segment Revenue (External + Internal)

  b) Segment Result

  c) Segment Asset

  d) Segment Liabilities

  e) Capital expenditure incurred during the period

  f) Depreciation charge for the period

  g) Other non cash expenses during the period

- If Geographical segments are primary, then business segments are secondary and Vice versa.

Common Errors

Item/ Transaction	Observations	Requirement	What should one remember
Segment disclosures made in consolidated financial statements	Where companies opt to present segment disclosures only in the consolidated financial statements, no reference to this fact is made in the standalone financial statements	While AS – 17 does allow under paragraph 4 to present segment disclosures only in consolidated financial statements where it is a part of the single financial report, it would be appropriate to disclose the fact in the standalone financial statements that the disclosures are being made in the consolidated financial statements	Ensure that the standalone financial statements include a note that segment disclosures are made in the consolidated financial statements

Common Errors (Contd)

Item/ Transaction	Observations	Requirement	What should one remember
Geographical segments	In certain cases, where the entity has sales within and outside India, geographical segments are not disclosed	Normally where an entity has both domestic and export sales, it indicates that entity may have geographical segment per AS 17. However, where risk and returns are the same, there may be a situation where information for geographical segments are not required to be disclosed	Ensure that where the entity does not have any reportable segments despite having domestic and export sales, such fact and the reason for the same are clearly specified in the note

FRRB Observations

Certain enterprises which do not have any separate business segments have stated that they consider business segment to be primary segment. They have disclosed the information about the geographical segments as secondary segments and made disclosures accordingly, which are less than disclosures required for primary segments. This is not strictly in accordance with AS 17. In case an enterprise does not have separate business segments but has separate geographical segments, geographical segments should constitute primary segments for the enterprise.

Your questions

Thank you