



N.A.SHAH ASSOCIATES LLP
Chartered Accountants

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EXECUTIVE SUMMARY:

- **Accounting**

- **Expert Advisory Opinion**

Based on the facts of the case, in terms of the agreement between the Company and franchisee, the Company shall hand over its outstanding trade receivables to the franchisee. Accordingly, Company transferred the outstanding trade receivables to the franchisee and made equivalent provision towards doubtful trade receivable. The committee is of the view that this accounting treatment is not correct. The above view is considering that outstanding trade receivables are transferred to the franchisee for the agreement period and hence such amount should be transferred to another asset account instead of making provision for doubtful trade receivable.

- **Deferred tax accounting not applicable to specified government companies**

- **Auditing**

- **Revised SA 299 'Joint audit of financial statements'**

The ICAI has issued revised Standard on Auditing on joint audits of financial statements. This revised Standard on Auditing is effective for audits of financial statements for periods beginning on or after April 1, 2018.

- **Company Law**

- Amendment to The Companies (Share Capital and Debentures) Rules, 2014 related to issue of physical share certificates. The amendment is mainly in respect to signatories who are authorized to issue the share certificates.

- **Other updates**

- Financial Reporting Review Board (FRRB) of the Institute of Chartered Accountants of India (ICAI) issued its new volume containing their observations on compliance with financial reporting requirements by listed and other companies.

1 Accounting

1.1 Expert Advisory Opinion

Provision for Debtors transferred to Franchisee

a) Facts of the case

The Company is engaged in business of electricity distribution in Indore & Ujjain and is governed by The Electricity Act, 2003. The Company entered into a Distribution Franchisee Agreement to minimize aggregate technical & commercial losses, improve distribution and operational efficiency, minimize billing arrears etc., in the area of Ujjain city.

The key terms of the agreement are summarized below:

- a. Franchisee agreement is for 15 years from the effective date of agreement.
- b. Outstanding trade receivable on the effective date of agreement will be transferred to franchisee after excluding the following amounts and no separate consideration is receivable from the franchisee against transferred trade receivable:
 - i. Arrear amounts in litigation.
 - ii. Amounts collected within three months from the effective date of agreement.
- c. Franchisee will collect the amounts from parties and retain those amounts.
- d. On expiry of 15 years of agreement (or earlier if there is default on part of franchisee), the closing trade receivables excluding the amounts collected within three months of the last billing cycle and arrears amounts in litigation will be transferred to the Company.

The accounting treatment followed by the Company on transfer of trade receivable is as given below:

- a. Trade receivable transferred to franchisee aggregating to Rs. 38.84 crore is continued to be retained in balance sheet as trade receivable.
- b. Provision for doubtful trade receivable is made to the extent of above amount and offset with the trade receivable balance.

b) Query

1. Whether the booking of loss upon transfer of debtors is correct or not as per Generally Accepted Accounting Principles.
2. The amount of provision for doubtful debts on such sundry debtors is Rs. 38.84 crore against the annual turnover of Rs. 8,268.45 crores for the Company. Whether, in the light of principle of materiality, the treatment given by the Company in its books of account is correct or not.

c) Points considered by the Committee

The Committee notes that the basic issue raised by the Company relates to booking of loss on transfer of debtors of Rs. 38.84 crore to the Franchisee by way of provision for doubtful debts. Further, the committee noted that Company has not made any provision towards doubtful trade receivables before transferring it to the franchisee.

The Committee does not agree that derecognition and provision for doubtful debts, which will offset gross carrying amount of debtors, have the same effect on the presentation in the balance sheet. Derecognition means removal of an item from the balance sheet whereas offset does not result in such removal.

Based on the facts of the case the committee refers to the following relevant principles:

1. Contractual rights to collect from trade receivable is transferred from the Company to the franchisee and hence it does not meet the requirement of asset in books of the Company.
2. Significant risk and rewards of ownership of the transferred trade receivables have been transferred to the franchisee.
3. Based on above, the Company does not have control on such asset after transfer. Hence such asset needs to be derecognized and the carrying amount of the transferred debtors should be transferred to an appropriate account.
4. On derecognition of trade receivable, question of making provision for doubtful debts does not arise.

d) Opinion

1. The booking of loss upon transfer of debtors by the Company is not correct. The committee is of the view that as the debtors are transferred to the franchisee. The same should be derecognized and the carrying amount of the transferred debtors should be transferred to an appropriate account (alternate asset) in the balance sheet. Subsequent clearance from this account should be made in an appropriate manner taking into account the nature and quantum of benefits expected to be obtained by the Company during the period of franchisee agreement.

2. As per the information available the amount involved is not material but the committee is of the view that level of materiality must be determined on the basis of specific facts and circumstances of the Company. For this purpose, apart from the volume of transactions and quantum of turnover, other factors such as nature of the item, impact on profit/loss etc. must also be considered.

1.2 Exemption to government companies from deferred tax accounting

Deferred Tax Asset (DTA)/Deferred Tax Liability (DTL) in the financial statements will not be applicable to specified government company which:

- is a Public Financial Institution as per Companies Act, 2013
- is registered with RBI as NBFC; and
- is engaged in the business of infrastructure finance leasing with not less than 75 % of its total revenue being generated from such business with government companies or other entities owned or controlled by the government.

Earlier the exemption was available for seven years up to 31st March 2024. The MCA has amended the earlier notification and now this exemption is available indefinitely to government companies.

2 Auditing

2.1 Revised SA 299 'Joint audit of financial statements'

This standard on auditing lays down the principles for effective conduct of joint audits to achieve the overall objectives of the auditor as laid down in SA 200 "Overall Objectives of the Independent Auditor and the conduct of an audit in accordance with Standards on Auditing".

This revised standard on auditing is effective for audits of financial statements for periods beginning on or after April 1, 2018.

3 Company Law

3.1 Amended to Share Capital and Debentures Rules

The Companies (Share Capital and Debentures) Rules, 2014 are amended to provide that the share certificates issued in physical form are required to be signed by two directors (any two directors of the company) or a director (any director of the company) and a company secretary, where appointed. Earlier the requirement was that the certificates would mandatorily be signed by company secretary (wherever appointed) in addition to two directors.

4 Other updates

4.1 Compilations of observations from FRRB

Financial Reporting Review Board (FRRB) of the Institute of Chartered Accountants of India (ICAI) issued its new volume summarising the observations on compliance with financial reporting requirements by listed and other companies. It is based on instances of non-compliance by certain companies with regard to the reporting requirements prescribed under:

- Accounting and Auditing Standards
- Companies Act, 2013 and erstwhile Act
- Companies (Auditor's Report) Order (CARO)

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