Common Errors found by FRRB in Implementation of AS 3 *Cash Flow Statements*

Financial Statements are the paramount source in hands of the stakeholders to understand the financial well-being of an enterprise. The users are highly reliant on the information depicted in the financial statements and, therefore, the preparers ought to ensure that the information presented in the financial statement is correct, complete, relevant and in adherence to the regulatory requirements. Financial Reporting Review Board (hereinafter referred as FRRB or Board) reviews the General Purpose Financial Statements (GPFS) of enterprises with the view to identify the non-compliances with Accounting and Auditing Standards, CARO, Companies Act, and other statutory requirements applicable in preparation and presentation of the financial statements. The non-compliances observed by the Board are compiled from time to time and published under the name of "Study on Compliance with Financial Reporting Requirement." Till date three volumes of the aforesaid publication have been released by the Board. In addition, the Board publishes articles in the 'Journal' of the Institute and also conduct 'webinar' on non-compliances with various reporting requirements to disseminate the awareness amongst the members as well as general masses. This article deals with the non-compliances, observed by the Board, with disclosure requirements prescribed under Accounting Standard – 3.

1. Non-Adjustment of Unrealised Foreign Exchange Gain/ Loss

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.

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Principle

It may be noted that Paragraph 27 of AS 3, Cash Flow Statements, notified under the Companies (Accounting Standard) Rules, 2006 provides that;

"27.Unrealised gains and losses arising from changes in foreign exchange rates are not cash flows. However, the effect of exchange rate changes on cash and cash equivalents held or due in foreign currency is reported in cash flow statement in order to reconcile cash and cash equivalents at the beginning and end of the period. This amount is presented separately from cash flows from operating, investing, and financing activities and includes the differences, if any, had those cash flows been reported at the end of the period exchange rates."

Observation

It was observed from note of Administrative and other expenses that although that exchange fluctuation has been reported at Rs. XXX, however, the same has not been adjusted to determine cash flow from operating activities. **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.

Accordingly, it was viewed that the Cash flow Statement has not been prepared in accordance with AS 3.

2. Interest expense has been reported at net figures 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

It may be noted that Paragraph 30 of AS 3, Cash Flow Statements, notified under the Companies (Accounting Standard) Rules, 2006 provides that;

"30.Cash flows from interest and dividends received and paid should each be disclosed separately. Cash flows arising from interest paid and dividends received in the case of a financial enterprise should be classified as cash flows arising from operating activities. In the case of other enterprises, cash flows arising from interest paid should be classified as cash flows from financing activities while interest and dividends received should be classified as cash flows from investing activities. Dividends paid should be classified as cash flows from financing activities."

Observation

It was noted that as per aforesaid requirement, in case of non-financial entities, cash flow on account of interest paid is the 'cash flow arising from financing activities' and cash flow on account of interest income is 'cash flow arising from investing activities'. It has been noted that the cash flow arising due to interest expenses has been reported at net figures which indicate that cash flow arising as interest income may have been netted off against the interest expenses. 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 cannot be netted off against each other.**

Accordingly, it was viewed that the requirement of Paragraph 30 of AS 3 has not been followed.

3. Incorrect Disclosure of Corporate Dividend Tax in Cash Flow Statement.

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

It may be noted that Paragraph 34 & 35 of AS 3, Cash Flow Statements, notified under the Companies (Accounting Standard) Rules, 2006 provides that;

"34. Cash flows arising from taxes on income should be separately disclosed and should be classified as cash flows from operating activities unless they can be specifically identified with financing and investing activities."

"35. Taxes on income arise on transaction that gives rise to cash flows that are classified operating, investing or financing activities in a cash flow statement. While tax expenses may be readily identifiable with investing or financing activities, the related tax cash flows are often impracticable to identify and may arise in a different period from the cash flows of that underlying transactions. Therefore, taxes paid are usually classified as cash flows from operating activates. However, when it is practicable to identify the tax cash flow with an individual transaction that gives rise to cash flows that are classified as investing or financing activities, the tax cash flow is classified as an investing or financing activity as appropriate. When tax cash flows are allocated over more than one class of activity, the total amount of tax paid is disclosed."

Observation

It was observed from financial statements of certain companies that although dividend paid has been disclosed under the heading 'Cash Flow from Financing Activities', however, 'tax on dividend paid (corporate dividend tax)' has been disclosed under the heading 'Cash Flow from Operating Activities'. It may be noted that the tax on dividend paid (corporate dividend tax) is related to distribution of profits. The Guidance Note on Accounting for Corporate Dividend Tax also 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 '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'. It is not in line with the requirements of AS 3.

4. Exclusion of earmarked funds, unpaid dividends etc. which are not readily available with the enterprise for its use.

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 and the total of these components matches with the closing cash & cash equivalents as reported in the cash flow statement.

Principle

It may be noted that paragraph 5.2 of AS 3, Cash Flow Statements, notified under Companies (Accounting Standards) Rules, 2006, provides that:

"5.2 Cash equivalents are short term, highly liquid investments that are readily convertible into known amounts of cash and which are subjects to an insignificant risk of changes in values."

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 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'.**

Accordingly, it was viewed that the requirement of AS 3 has not been complied with.

5. Wrong classification of increase / decrease in long term loans and advances and the cash flow arising from

the receipt and repayment of the same reported on Net basis in the Cash Flow Statement.

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

It may be noted that Paragraph 15 (e) & (f) and paragraph 21 of AS 3, Cash Flow Statements, notified under the Companies (Accounting Standards) Rules, 2006 provide that;

"15. The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which expenditures have been made for resources intended to generate future income and cash flows. Examples of cash flows arising from investing activities are:

(a) ...

(b) ...

...

(e) cash advances and loans made to third parties (other than advances and loans made by a financial enterprise);

(f) cash receipts from the repayment of advances and loans made to third parties (other than advances and loans of a financial enterprise);"

"21. An enterprise should report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities, except to the extent that cash flows described in paragraph 22 and 24 are reported on a net basis."

"22. 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."

24. Cash flows arising from each of the following activities of a financial enterprise may be reported on a net basis:

(a) cash receipts and payments for the acceptance and repayment of deposits with a fixed maturity date;

(b) the placement of deposits with and withdrawal of deposits from other financial enterprises; and

(c) cash advances and loans made to customers and the repayment of those advances and loans."

Observation

It was noted from the cash flow statement that Decrease/ (Increase) in long term loans and advances has been adjusted as working capital changes under the head 'cash flow from operating activity.' It was viewed that cash flow from operating activities signify cash flows primarily occurring due to principal revenue generating activities of the enterprise. However, 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 shown as required under paragraph 21 of AS 3.

Accordingly, it was viewed that the requirements of AS 3 have not been complied with. ■