Common Errors found by FRRB in implementation of AS 11: *The Effects of Changes in Foreign Exchange Rates* and AS 20: *Earnings Per Share*

Financial Statements are paramount source in the hands of stakeholders to understand the financial well-being of an enterprise. The users highly rely 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 also publishes articles in the Institute's Journal. on non-compliances with various reporting requirements; to disseminate the awareness amongst the members as well as general masses. Further, the Board also organises the webcasts on commonly found non-compliances on various accounting standards which are available on ICAI TV. This article deals with the non-compliances, observed by the Board, with disclosure requirements prescribed under Accounting Standard – 11 as well as Accounting Standard – 20.

AS 11: The Effects of Changes in Foreign Exchange Rates

1. Non-disclosure of Gain/Loss arising on Foreign Exchange Transactions

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: It may be noted that Paragraph 40(a) of AS 11 states that:

"40. An enterprise should disclose:

a. *the amount of exchange differences included in the net profit or loss for the period; and..."*

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**

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Profit and Loss or in notes to accounts which is not in line with the above stated requirement of AS 11.

2. **Incorrect valuation of Export Sales**

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: It may be noted that paragraph 9 of AS 11 requires that;

"9. A foreign currency transaction should be recorded, on initial recognition in the reporting currency, by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the transaction."

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

3. **Incorrect policy for translation of Non-Monetary items**

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: It may be noted that paragraph 11(a) of AS 11 provides that;

"11. At each Balance Sheet date:

(a) *foreign currency monetary items should be reported using the closing rate……."*

Observation : As per above mentioned 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.

Hence, recognising monetary item at contract rates is against the principles of AS 11.

4. **Incorrect policy for translation of monetary items**

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: It may be noted that paragraph 11(a) of AS 11, provides as follows:

"11. At each balance sheet date:

(a) *Foreign currency monetary items should be reported using the closing rate. However, in certain circumstances, the closing rate may not reflect with reasonable accuracy the amount in reporting currency that is likely to be realised from, or required to disburse, a foreign currency monetary item at the balance sheet date, e.g., where there are restrictions on remittances or where the closing rate is unrealistic and it is not possible to effect an exchange of currencies at that rate at the balance sheet date. In such circumstances, the relevant monetary item should be reported in the reporting currency at the amount which is likely to be realised from, or required to disburse, such item at the balance sheet date."*

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.

AS 20: Earnings Per Share

1. Disclosure of Diluted EPS was stated as Not Applicable

Case: From the Notes to Accounts of a company, it was noted that the diluted earnings per share has been stated to be as Not Applicable.

Principle: It may be noted that paragraph 26 and 41 of AS 20 states that:

"26. For the purpose of calculating diluted earnings per share, the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares."

"41. Potential equity shares are anti-dilutive when their conversion to equity shares would increase earnings per share from continuing ordinary activities or decrease loss per share from continuing ordinary activities. The effects of anti-dilutive potential equity shares are ignored in calculating diluted earnings per share."

Observation: It appears that the company has stated Diluted EPS at Not Applicable 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 earnings per share. 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 earnings per share 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.

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.

2. Non-disclosure of the type of EPS

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, provides that:

"8. An enterprise should present basic and diluted earnings per share on the face of the statement of profit and loss for each class of equity shares that has a different right to share in the net profit for the period. An enterprise should present basic and diluted earnings per share with equal prominence for all periods presented."

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.

3. Non-disclosure of nominal value of shares

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, requires that:

"48. In addition to disclosures as required by paragraphs 8, 9 and 44 of this Statement, an enterprise should disclose the following:

...

(ii) (c) the nominal value of shares along with the earnings per share figures."

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 basic and diluted EPS was disclosed, however, the nominal value of shares as required by Paragraph 48 (ii) (c) of AS 20 was not disclosed.

4. **Incorrect calculation of weighted average number of shares**

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

Principle: It may be noted that paragraph 15 of AS 20, states that:

"15. For the purpose of calculating basic earnings per share, the number of equity shares should be the weighted average number of equity shares outstanding during the period."

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.

5. **Share Application Money not considered for computing Diluted EPS**

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

Principle: It may be noted that paragraphs 28 and 32 of AS 20, provide as follows:

"28. For the purpose of this Standard, share application money pending allotment or any advance share application money as at the balance sheet date, which is not statutorily required to be kept separately and is being utilised in the business of the enterprise, is treated in the same manner as dilutive potential equity shares for the purpose of calculation of diluted earnings per share."

"32. For the purpose of calculating diluted earnings per share, the number of equity share should be the aggregate of the weighted average number of equity shares calculated in accordance with paragraphs 15 and 22, and the weighted average number of equity shares which would be issued on the conversion of all the dilutive potential equity shares into equity shares. Dilutive potential equity shares should be deemed to have been converted into equity shares at the beginning of the period or, if issued later, the date of the issue of the potential equity shares."

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 diluted earnings per share** which is against aforesaid requirements of AS 20.

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 as nil, which is incorrect.

6. **Incorrect Disclosure of EPS**

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: It may be noted that Paragraph 9 of AS 20, states as follows:

"9. This Standard requires an enterprise to present basic and diluted earnings per share, even if the amounts disclosed are negative (a loss per share)."

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 as nil,** which is incorrect.■