

# **CFO – Compliances and Challenges**

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# CFOs to be blamed for most of frauds, says Sebi WTM Mohanty

"In retrospect, on the basis of the analysis we have done, many of the frauds could have been prevented if CFO would have acted as the first level of check to these activities of the management," he said, addressing a CFO summit organised by industry lobby Ficci.



PTI

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1000 Industry Professionals

Chief financial officers are responsible for most of the frauds that have been witnessed in India, a senior official from Sebi said on Friday, citing an analysis done by the capital markets regulator. The role of the CFOs extends much beyond keeping accounts of the business, and Sebi looks at them as "critical gatekeepers for ensuring the integrity of the market", its Whole Time Member SK Mohanty said.

# Few Questions !!

- 1) Have you ensured that for FY 2022-2023, impending changes are disclosed in the F.S.
- 2) Have you considered and identified the difference between Ind AS and ICDS for Form 3CD
- 3) Have you considered the impact of PMLA Notifications for reporting the matters to FIU
- 4) Have you considered the impact of PMLA on the re-engineering of internal control system
- 5) Have you considered the quality of financial reporting in accordance with FRRB observations
- 6) Have you considered the CSR impact assessment report while evaluating efficiency and effectiveness of CSR Controls
- 7) Have you considered the new requirements as to IT control system arising due to audit trail requirements
- 8) Have you considered the implications of amendments made in LODR requirements on the financial governance of your enterprise

# CFOs ~ whether the next “whipping boys”

- It seems that the next in line are the CFOs who are going to be the "whipping boys". In my view, CFOs should fasten their seat belts for the following:
  - ✓ internal mechanism under PML Rules;
  - ✓ control systems for UPSI;
  - ✓ corporate governance practices - more specifically for related party transactions;
  - ✓ material events and transactions;
  - ✓ books of account and financial statements;
  - ✓ BRSR and ESG reporting

# What is the term CFO Means

- "Chief Financial Officer" means a person **appointed** as the Chief Financial Officer of a company – Section 2(19) of the Companies Act, 2013 (“the Act”);
- CFO is also considered as **KMP** under section 2(51)(iv) of the Act;
- "Chief Financial Officer" or "whole time finance director" or "head of finance", by whatever name called, shall mean the person heading and discharging the finance function of the listed entity as disclosed by it to the recognised stock exchange(s) in its filing under these regulations ~ Regulation 2(1)(f) of SEBI LODR
- CFO is also considered as “senior management’ under Regulation 16(d) of SEBI LODR;
- Primarily and conventionally, the duties of the CFO are handling the cash flows and financial planning as well as analysing the company’s financial health;
- If the company faces any issues, the CFO takes corrective actions.

# Companies Act and CFO

- **Books of account, etc., to be kept by company** ~ failure to comply the provisions ~ CFO ~ punishable with fine which shall not be less than Rs. 50,000 but which may extend to Rs. 5,00,000 [Section 128(6)];
- **Financial Statements to present true and fair view** ~ failure to comply the provisions ~ CFO ~ punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than Rs. 50,000 but which may extend to Rs. 5,00,000, or with both [Section 129(7)];
- **Signing of Financial Statements** ~ failure to comply the provisions ~ CFO ~ liable to a penalty of Rs. 50,000 [Section 134(8)];
- **Copy of financial statements to be filed with Registrar** ~ failure to comply the provisions ~ CFO ~ liable to a penalty of Rs. 10,000 and in case of continuing failure, with a further penalty of Rs. 100 for each day after the first during which such failure continues, subject to a maximum of Rs. 50,000 [Section 137(3)]

# Companies Act and KMP

- **Multiple Positions** ~ whole-time key managerial personnel shall not hold office in more than one company except in its subsidiary company at the same time ~ if defaults ~ liable to a penalty of Rs. 50,000 and where the default is a continuing one, with a further penalty of Rs. 1,000 for each day after the first during which such default continues but not exceeding Rs. 5,00,000 [Section 203(5)];
- **Disclosure of interest and register of contracts or arrangements in which he is interested** ~ within a period of 30 days of his appointment, or relinquishment of his office, as the case may be, disclose to the company the particulars relating to his concern or interest in the other associations which are required to be included in the register ~ if defaults ~ liable to a penalty of Rs. 25,000 [Section 189(6)];
- **Audit Committee** ~ key managerial personnel shall have a right to be heard in the meetings of the Audit Committee when it considers the auditor's report but shall not have the right to vote [Section 177(7)]

# SEBI LODR and CFO/ KMP

- CFO to provide the **compliance certificate** to the board of directors as specified in Part B of Schedule II [Regulation 17(8)]:
  - reviewed financial statements and the cash flow statement;
  - no transactions entered into by the listed entity during the year which are fraudulent, illegal or violative of the listed entity's code of conduct;
  - accept responsibility for establishing and maintaining internal controls for financial reporting;
  - indicated to the auditors and the Audit committee ~ significant changes in ICOFR, accounting policies and instances of significant fraud
- KMP to **disclose** to the board of directors whether they, directly, indirectly, or on behalf of third parties, have a **material interest** in any transaction or matter directly affecting the listed entity [Regulation 4(i)(1)]





**Biggest  
Challenges  
for CFOs**

# Talent acquisition and retention

- many challenges in finding people with the right skills to staff their departments;
- prioritising technology literacy when assessing new recruitments;
- communication skills

# Add automation with technology

- connecting the workforce remotely;
- financial forecasting with machine learning, robotic process automation and block chain

# Prevent fraud and invest in cybersecurity

- Need to recognise the requirements to protect sensitive data and the potential costs that cyberattacks can cause;
- The expected stability of remote workforces adds a new section for CFOs handling potential fraud and cybersecurity risks and makes the cloud more appealing, providing its security gain

# Ensure compliance

- In the present stage, CFOs are commonly responsible for ensuring regulatory compliance for their organisations. For example, historical changes in GAAP (generally accepted accounting principles) on lease accounting, disclosures on environmental is increased, societal and governance (**ESG**) factors, related party transactions, and modifications in fair lending reporting required significant compliance projects.
- changes in taxation, like income tax and goods and services tax, may significantly impact operations



**Precedents ~  
Commonly  
observed  
non-  
compliances**

# Common mistakes in BRSR report

- the vulnerable groups are not properly identified due to lack or absence of any policy for the same but still it's reported without any qualifications;
- on one hand it is reported that the company adopts high standards for employees' rights but on the other hand the attrition rate in the company is also high;
- the company reports that its products are safe and durable but on the other hand the annual report, notes to accounts and media reports mention the ongoing litigation in consumer forums for deficiencies;
- the report claims that company take care of human rights but on the other hand the company's HR policy do not allow graduates from hindi medium school to be considered for Finance Division

# Issue 1: Inventory

While preparing its financial statements and while framing its accounting policies, Company 'X', has used the following words:

*'Inventories are valued using weighted average cost method or specific identification method as applicable'.*

Whether the accounting policy has been disclosed properly.



# Ind AS 1, Ind AS 2 read with Schedule III

- **Ind AS 1:** To ensure proper understanding of F.S., it is necessary that all significant accounting policies adopted in the preparation and presentation of F.S. should be disclosed.
- **Ind AS 2:** The F.S. should disclose the accounting policies adopted in measuring inventories, including the cost formula used, the total carrying amount of inventories and its classification appropriate to the enterprise
  - Raw materials
  - Work-in-progress
  - Finished goods
  - Stock-in-trade (in respect of goods acquired for trading)
  - Stores and spares
  - Loose tools

## Note:

- Mode of valuation shall be stated
- Goods in transit for each category to be specified separately

# Issue 2: Cash Flow Statement

In the cash flow statement an entity has categorised its cash flows during a particular period into four categories, which are, Cash flow from Operating Activities, Cash flow From Investing Activities, Cash Flow from Financing Activities and Cash flow from Other Activities.

Whether the entity has categorised its cash flows correctly as per Ind AS 7, Cash Flow Statements?

Particulars	Amount (Rs.)	Amount (Rs.)
Net Profit before Tax	1,000	
Non-cash items and working capital adjustments	(100)	
Cash from Operating Activities (A)		900
Cash from Investment Activities (B)		500
Cash from Financing Activities (C)		(200)
<b>Net increase in cash and cash equivalents [(A) + (B) + (C)]</b>		<b>1,200</b>
<b>Cash and cash equivalents at beginning of period (D)</b>		<b>1,800</b>
<b>Cash and cash equivalents at end of period (E)</b>		<b>3,100</b>
<b>Changes during year on account of (D) and (E)</b>		<b>1,300</b>

Particulars	Amount (Rs.)	Amount (Rs.)
Net Profit before Tax	1,000	
Non-cash items and working capital adjustments	(100)	
Cash from Operating Activities		900
Cash from Investment Activities		500
Cash from Financing Activities		(200)
<b>Cash from Other Activities</b>		<b>100</b>
<b>Net increase in cash and cash equivalents</b>		<b>1,300</b>
<b>Cash and cash equivalents at beginning of period</b>		<b>1,800</b>
<b>Cash and cash equivalents at end of period</b>		<b>3,100</b>

# Issue 3: Earning Per Share

A company (company Z) has prepared its financial statements for the year ended March 31, 20XX. During the year April 1, 20XX to March 31, 20XX, Company Z has issued new equity shares. The company has computed Basic Earnings Per Share (BEPS) by dividing the net profit for the period attributable to the equity shareholders by number of equity shares outstanding at the end of the year.

Whether Company Z has computed BEPS correctly

- RST Limited
- 1<sup>st</sup> April, 2022 – Equity Shares – 10,000 shares
- 1<sup>st</sup> Oct, 2022 – fresh issue – 1,000 shares (additionally issued)
- 31<sup>st</sup> March, 2023 – outstanding equity shares – 11,000 shares
- PAT = Rs. 1,10,000
- BEPS =  $1,10,000 / 11,000 = \text{Rs. } 10$  = is it correct ? = no
- Weighted Avg. Number of Equity Shares =  $[(10,000 \times 12/12) + (1,000 \times 6/12)]$   
= '10,500' number of shares
- BEPS =  $1,10,000 / '10,500' = \text{Rs. } 10.48$  = this is correct position as per Ind AS 33

# Issue 4: Pre-fixed Forex Rate

A Special Economic Zone (SEZ) unit which is a company (A Ltd.), is engaged in the business of manufacturing of parts of laptops. It imports raw materials for manufacturing of parts and exports almost all units it produces. For the purpose of recording the import and export transactions in the reporting currency the company uses a prefixed exchange rate. A Ltd. fixes exchange rate as on first day of the financial year.

Now, the question arises whether foreign currency transactions can be recognised at prefixed exchange rate?

- As per Ind AS 21, 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.
- Therefore, A Ltd. should record the import and export transactions at the rate prevailing on the date of transaction. It can't use any prefixed rate.



## Issue 5: Government Grants related to revenue and clubbing with sales

A company (say Company X) is engaged in the business of manufacturing and selling of tea. During the previous financial year it had received subsidy on fertilisers from the government. While preparing financial statements for previous year, X has clubbed the amount of subsidy with revenue of that year.

Is accounting treatment of governmental subsidy correct?

- As per Ind AS 20, Government grants related to revenue should be recognised on a systematic basis in the profit and loss statement over the periods necessary to match them with the related costs which they are intended to compensate. **Such grants should either be shown separately under 'other income' or deducted in reporting the related expense.**
- Therefore, the company X should disclose the subsidy on fertilisers as other income or should net off the amount of subsidy from the expenditure incurred on purchase of fertilisers.

# Issue 6: Provision for gratuity

An entity has a rule that no gratuity shall be payable to an employee if he or she leaves service before completion of five years. The company believes that no liability should be accrued for gratuity till the first five years of an employee.

Is the contention of the company correct ?

- Albeit the gratuity benefit may not vest in first five years, yet there is a probability that certain employees shall complete five years and shall become eligible for gratuity. Merely because a benefit has not vested does not mean that the obligation does not exist. **The 'probability' concept account for percentage of employees for which the benefit will/ will not vest.** Accordingly, provision should be created during the first five years of service.
- In other words, **the benefit of gratuity although becomes payable after 5 years but the obligation accrues over a period of 5 years.** Hence an entity must estimate the number of employees who will become eligible for gratuity (depending upon the attrition percentage across different levels) and accordingly estimate the amount of provision required each year even if the employees are not eligible for gratuity as on date.

## **Issue 7: Interest on borrowed funds, initially capitalized as per accrual concept but later waived off by lenders**

A company is engaged in business of manufacturing and sale of chemicals. The company borrowed funds for purchasing of assets in the preceding years. Interest cost on the borrowed funds was capitalised in accordance with the laws and regulations till the time of commercial production. Later on after the start of commercial production, no interest was paid to lender because of the financial problems. During the current year the company repaid the principal amount to the lenders and as per the arrangement the lenders waived off the interest which was already capitalised. The company recognised the waived interest as capital reserve. How should such interest waiver be treated in books of account ?

- No, the interest waiver cannot be recognised as a capital reserve. Instead, **the interest that has been capitalised as part of the historical cost of the asset and has subsequently been waived off, should be reduced from the fixed asset cost and accumulated depreciation.** The adjustment should be carried out as on the date of waiver. The rationale is that, since the asset has been correctly capitalised based on actual cost incurred, but subsequently not paid, the capitalised amount of the fixed asset should be reduced - EAC opinion Query 23 Volume 23

<b>Particulars [Rs. In Cr.]</b>	<b>Case 1</b>	<b>Case 2</b>
<b>Paid up Capital</b>	<b>150</b>	<b>150</b>
<b>Free Reserves + Securities Premium</b>	<b>20</b>	<b>20</b>
<b>Total</b>	<b>170</b>	<b>170</b>
<b>O/s W.C. Loan (repayable on demand): GE Capital</b>	<b>50</b>	<b>50</b>
<b>CC from PNB (repayable on demand - Existing)</b>	<b>120</b>	<b>120</b>
<b>6 Months loan for Plant from PNB (Proposed)</b>	<b>50</b>	<b>60</b>
<b>24 Months loan for Plant from PNB (Proposed)</b>	<b>30</b>	<b>80</b>
<b>Total</b>	<b>250</b>	<b>310</b>
<b>Resolutions</b>	<b>??</b>	<b>??</b>

c) Borrowings (current + proposed) > Paid up Share Capital + Free Reserves + Securities Premium A/c [w.e.f. 9.2.2018];

- **Exception:** No SR approval required for temporary loans obtained from company's bankers in the ordinary course of business.

**"Temporary Loans"** means:

(a) loans repayable on demand; or

(b) payable within 6 months from the date of the loan [such as OD/ CC Limits, Bills discounted, seasonal loans, etc.]

**Note:**

- **Temporary Loans do not include loans** raised for the purpose of financing **capital expenditure**



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<b>Total</b>	<b>250</b>	<b>310</b>
<b>Borrowings other than Temporary Loans</b>	<b>130</b>	<b>190</b>
<b>Resolutions</b>	<b>BR</b>	<b>SR</b>

**Thank You**