

**CONFIDENTIAL**

**DISCIPLINARY COMMITTEE [BENCH-III (2019-20)]**

**[Constituted under section 21B of the Chartered Accountants Act, 1949]**

**Findings under Rule 18(17) read with 19(2) of the Chartered Accountants (Procedure of Investigations of Professional and Other Misconduct and Conduct of Cases) Rules, 2007**

**File no. : PPR/P/9/W/2013-DD/44/W/INF/13-DC/614/2017**

**In the matter of:**

**CA. Bharatkumar A Shah (M.No.032281)**

512, Vyapar,  
49, P.D. Mello Road,  
Carnac Nunder,  
**Mumbai- 400009**

**.....Respondent**

**Members Present:**

**CA. Prafulla Premasukh Chhajed, Presiding Officer  
Smt. Anita Kapur, Member (Govt. Nominee)  
Shri Ajay Mittal, Member (Govt. Nominee)**

**Date of Final Hearing: 20<sup>th</sup>-21<sup>st</sup> August, 2019 (decided on 23<sup>rd</sup> September, 2019)**

**Place of Final Hearing: Mumbai**

**Parties Present:-**

**CA. Bharatkumar A. Shah – Respondent**

**Allegations of the Informant, GM, SEBI, Mumbai:**

1. The Respondent was the auditor of M/s Jawed Habib Hair and Beauty Limited (hereinafter referred to as the "**Company**"). The Company had filed a draft letter of Offer dated 24<sup>th</sup> January, 2011 for an Initial Public Offering (IPO). During examination, it was found that there were several irregularities in the financials of the Company:
  - i. The Company had entered into an agreement dated 27<sup>th</sup> August, 2010 with M/s. Katha Mediatix Limited (hereinafter referred to as **M/s Katha**) for Rs. 5 Crores for providing space in 220 centres (neither owned nor leased by the Company) to M/s Katha. The Company had booked the entire amount on the date of agreement itself while the agreement was for three years. The Company had wrongly classified non-operational income from letting out space to M/s Katha as income from operations.
  - ii. The Company had entered into an agreement with M/s Global CIP Sdn Bhd (hereinafter referred to as M/s Global) for USD 1 million (Rs. 4.42 crores) dated 15<sup>th</sup> May, 2010 for a period of three years as per which the Company permitted M/s Global to make use of Jawed Habib Hair and Beauty Courses for teaching the students in Asia Pacific region excluding India. The Company had booked the full amount on the date of agreement itself whereas the amount was not realized till Financial Year 2011-12.
  - iii. The Company had changed the method of revenue recognition for the years 2009-2010 and 2010-11 without proper disclosures in DRHP (Draft Red Herring Prospectus).

**Proceedings:**

2. At the time of hearing on 20<sup>th</sup> August 2019, the Committee noted that the Respondent was present. The Committee, thereafter, informed the Respondent that the composition of the Committee had undergone a change; therefore an option of de-novo hearing in the matter was available to him. The Respondent requested that hearing might be proceeded with further and the evidences already available on record might be adopted by the Committee. The Respondent further stated that he had nothing further to submit before the

Committee and that the Committee might decide on the matter based on the documents/information already available on record. Accordingly, hearing in the matter was concluded.

3. On 23<sup>rd</sup> September, 2019, the Committee considered the documents available on record and decided the case on merits.

**Findings of the Committee:**

4. The Committee noted that the first allegation against the Respondent was regarding the income from letting out the space to M/s Katha wherein two allegations were made. Firstly, the revenue was recognized on the date of agreement rather than over 3 years and secondly regarding its presentation which was alleged to be an exceptional item and non-recurring income of the Company and hence alleged to be classified under the head "Other Income" and not "Operational Income". It was noted that as regards first leg of allegation, the Director (Discipline) did not find the Respondent guilty of its in his prima facie opinion. Accordingly, the Committee proceeded against the Respondent in respect of second leg of the allegation. It was noted that the Informant had further stated that since the Company never entered into such kind of agreement with any other party for in the past or after filing the DRHP as declared by them (**A-72**), it should have been considered as exceptional item and was required to be disclosed separately for better understanding and comparisons to give true and fair view of the financial statements.

5. The Committee noted that the Respondent has submitted that the Company was earning income from operations majorly from its own saloons, from franchise outlets, sale of hair and beauty products and academy income and considered the income from all these sources as operational income since its inception. The Company had entered into agreements with various Franchisees and clause 8.3.2 of the Agreement entered with various Franchisees provides as under:

*“All revenue generated or earned from advertisements, branding, signages and display at/or at the Company’s salons and spas, services and products offered and or sold will term part of the revenue earned at the salon.”*

In the extant case, the Company had provided space in 220 centres to M/s Katha for advertisement at Franchisee outlets and as per the Agreement with the Franchisees, income from letting of space for letting display of its advertisement was a part of Company’s income from franchisee as agreed upon by it in the agreement in the reproduced clause. Hence, the same was accounted for as income from operations alongwith other Franchisee Income received. To elaborate his defense, the Respondent also brought on record the copy few sample franchise agreements entered into by the Company and copy of Memorandum of Association of the Company to submit that the said activity of the Company was not an *“exceptional and non-recurring”* income. In fact, it was income from the activity covered by the main and incidental objects of the Company.

6. The Committee viewed that agreements with franchisees carrying or dealing in Company’s saloons and spas, services and products salon were as per the main and incidental objects clauses of the Memorandum of Association of the Company. It was noted that income from franchisee constituted 33% of the total income of the Company for the F.Y.2010-11.

7. It was noted that as regard classification of an income, it can be classified as income from operations or other income. Further, AS 5 requires separate disclosure of ‘exceptional income’. It is noted that, in extant case, the Company was running its business through various franchisees so any income earned through business done by franchisee for agreements and business done by it was a part of its income from operations. With respect to its classification as exceptional income or otherwise, it was noted that the term ‘Exceptional items’ is not defined in any accounting standard. However, AS-5, “Net Profit or Loss for the period, Prior period items and Changes in Accounting Policies”, has a reference to such items in Paragraphs 12, 13 and 14 reproduced below:

*“12. When items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.*

*13. Although the items of income and expense described in paragraph 12 are not extraordinary items, the nature and amount of such items may be relevant to users of Financial Statements in understanding the financial position and performance of an enterprise and in making projections about financial position and performance. Disclosure of such information is sometimes made in the notes to the Financial Statements.*

*14. Circumstances which may give rise to the separate disclosure of items of income and expense in accordance with paragraph 12 include: the write-down of inventories to net realisable value as well as the reversal of such write-downs; a restructuring of the activities of an enterprise and the reversal of any provisions for the costs of restructuring;*

- ✓ disposals of items of fixed assets;*
- ✓ disposals of long-term investments;*
- ✓ legislative changes having retrospective application;*
- ✓ litigation settlements; and*
- ✓ other reversals of provisions.”*

It was noted that in extant case, income from franchisee was shown separately. Hence, the same was appropriately accounted for as an income from operations by way of Franchisee Income received in regular course of business. Accordingly, the Committee was of the view that the Respondent is not guilty with respect to this charge.

8. The Committee noted that the second allegation was as regard the agreement **(B-20 to B-28)** which was entered into by the Company with M/s Global for USD 1 million (Rs.4.42 crores) towards one time non-refundable fee for a period of three years to make use of Jawed Habib Hair and Beauty

Courses for teaching the students in Asia Pacific region excluding India. It was alleged that the agreement was for a period of three years but the full amount was booked on the date of agreement itself which was not realized even till the end of FY 2011-12.

9. The Committee noted the contention of the Respondent that the Company had assigned the rights to M/s Global to use trade name and trade mark of the Company to conduct hair and beauty courses for a period of 3 years against non-refundable fee of USD 1 million (Rs.4.42 crores). The assignment of right was one time transaction and the Company allowed the assignee to use its trade mark and trade name freely and gave delivery of study material initially against one-time non-refundable fee of Rs. 4.42 crores. He also stated that AS-9 provides that revenue should be recognized over a period of delivery of service, however in the instant case, in substance, the transaction got completed initially only as no other service was required to be performed by the Company further for performance of contract. Also that as per the accrual system of accounting, income should be booked in the first year itself.

As regards the FEMA violation, he stated that the Company had applied for extension of time with the bank for receipt of foreign exchange and as on the date of Audit report, the transaction was only 12 months old and hence he did not report the same as according to the normal audit practice, it was required to be reported if the transaction was too old.

10. With regard to this allegation, the Committee noted the agreement had entered into on 15<sup>th</sup> May 2010 **(B-21)** so as on the date of balance sheet a period of 12 months was yet to get over. It was further noted from the agreement that it did not contain the date by when the said consideration was required to be paid. Further, the terms of the Agreement was for assignment of user rights in the Company's trade-name and trade-mark to Global and it explicitly states that such payment was towards 'one time non-refundable fees'.

11. The Committee noted that as para 10 of AS-9 , the revenue from service transactions should be recognized when the requirement as to performance set out in paragraph 12 are satisfied, provided that at the time of performance, it is not unreasonable to expect ultimate collection. Further, para 12 of AS-9, provides that in a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method, whichever relates the revenue to the work accomplished and such performance should be regarded as being achieved when no significant uncertainty exists regarding the amount of consideration that would be derived from rendering the service. Paras 10 and 12 of AS-9 are extracted below:

*10. Revenue from sales or service transactions should be recognized when the requirements as to performance set out in paras 11 and 12 are satisfied, provided that at the time of performance it is not unreasonable to expect ultimate collection. If at the time of raising of any claim it is unreasonable to expect ultimate collection, revenue recognition should be postponed. (Emphasis supplied)*

*12. In a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method, whichever relates the revenue to the work accomplished. Such performance should be regarded as being achieved when no significant uncertainty exists regarding the amount of the consideration that will be derived for rendering the service. (Emphasis supplied)*

12. In light of above, the Committee was of the view that a Company recognizes revenue when it performs the service required and there is no uncertainty with respect to collection of revenue. In extant case, services were performed when it had delivered the material and also assigned the right to use trade mark. Further, there is nothing on record which points out that collection of revue was uncertain as on balance sheet date alongwith the

fact that reasonable period of 12 months was yet not over. Accordingly, the Committee was of the view that the Respondent is not guilty with respect to this charge.

13. The Committee noted that in the last allegation, it has been alleged against the Respondent that he failed to report that the Company had changed the method of revenue recognition for the years 2009-2010 and 2010-11 without proper disclosures in DRHP.

14. The Committee noted the submissions of the Respondent that the facts in this regard were misinterpreted as the method for recognizing the income from franchisee was as per the terms mentioned in the Agreement between the Company and the Franchisee and all the 3 methods were adopted by the Company with different franchisees in all the years till 2011. The Respondent also brought on record samples of different agreements to demonstrate that the difference in the nature of different business models adopted by the Company with different franchisees which was an incident of business governed by the business expediency.

15. In respect to the above mentioned allegation, the Committee noted the submissions of the Respondent that actually the facts were not correctly construed and the different methods for recognizing the income from franchisee due to different business models being adopted by the Company did not tantamount to a change on accounting policy as regard recognition of revenue. Accordingly, the Committee was of the view that since the Company had different types of agreements with different franchisees laying different sets of rights and obligation on the two parties to the agreement, hence, revenue would be recognized based on such rights. As such, no misconduct was attributable on part of the Respondent in this regard as accounting was done as per the agreed terms. Accordingly, the Committee held the Respondent not guilty with respect to this charge.

**CONCLUSION :**



16. Thus, in conclusion, in the opinion of the Committee, the Respondent is held **NOT GUILTY** of Professional Misconduct falling within the meaning of Clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949.

17. The Committee accordingly passes Order for closure of this case against the Respondent.

**Sd/-**  
**(CA. Prafulla Premsukh Chhajed)**  
**Presiding Officer**  
**Nominee)**

**Sd/-**  
**(Smt. Anita Kapur)**  
**Member (Govt.**

**Sd/-**  
**(Ajay Mittal)**  
**Member (Govt. Nominee)**

**Date : 15<sup>th</sup> January, 2020**  
**Place : New Delhi**