Non-compliances observed in the Ind AS Financial Statements pertaining to Assets Side in Balance Sheet

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 presented in the financial statements and therefore the preparers ought to ensure that it is correct, complete, relevant and adhere to the applicable regulatory requirements. The Financial Reporting Review Board (FRRB) reviews the General Purpose Financial Statements (GPFS) of enterprises with the view to identify the non-compliances with Accounting Standards/ Ind AS and Standards of Auditing, CARO, Companies Act, and other applicable statutory requirements. Read on...

The non-compliances observed by the Financial Reporting Review Board are compiled 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. Further, another publication, *Study on Compliance of Financial Reporting Requirements (Ind AS Framework)* has been released for preparers and auditors of the Ind AS financial statements. In addition, the Board publishes such non compliances observed by way of articles in the *Chartered Accountant Journal* of the Institute. This article is in furtherance of the FRRB's endeavour to update the members and other stakeholders in the field of financial reporting. It may be noted that in this article, the observations related to Ind AS framework have been classified on the basis of components of financial statements i.e., Assets, Equity, Liabilities for Balance Sheet and revenue, interest income, employee benefits etc for Statement Profit and Loss and likewise. This article deals with the non-compliances, observed by the Board, with regard to assets side in Balance Sheet which is an important element for Ind AS financial statements.

Observations related to Assets

1. Capitalisation of Subsequent Expenditure

Case

The accounting policy for Property, Plant and Equipment (PPE) reads as follows:

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"Subsequent expenditure related to an item of PPE is added to its carrying value only if it increases the future benefits from the existing asset beyond its previously assessed standard of performance."

Principle: Ind AS 16, Property, Plant and Equipment

Paragraph 7 – Recognition

The cost of an item of property, plant and equipment shall be recognized as an asset if, and only if:

(a) it is probable that future economic benefits associated with the item will flow to the entity; and

(b) the cost of the item can be measured reliably.

Paragraph 13 –*Subsequent* Cost

...Under the recognition principle in paragraph 7, an entity recognizes in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if the recognition criteria are met.

Observation:

As per paragraph 13 of Ind AS 16, subsequent expenditure would be recognized in the carrying amount of PPE when that cost/ expense would meet the recognition criteria given in paragraph 7 of Ind AS 16 i.e., *it is probable that future economic benefits associated with the item will flow to the entity and the cost of the item can be measured reliably.* **There is no criterion that capitalisation should be done only if there is increase of future benefits from the existing asset beyond previously assessed standard of performance'**.

Accordingly, it was viewed that the language of the stated policy is not in line with the component accounting concepts given in Ind AS 16.

2. **Disclosure of Capital Work in Progress**

Case

A company presented Property, Plant and Equipment and Capital Work-in-Progress as separate line items on the face of its balance sheet and there was a movement in the balances of Property, plant and equipment and Capital work-in-progress in the reporting year and the comparative year.

Principle: Ind AS 16, Property, Plant and Equipment

Paragraph 74 – Disclosure

"The financial statements shall also disclose:

(a) ....

(b) the amount of expenditures recognized in the carrying amount of an item of property, plant and equipment in the course of its construction."

Observation:

It was noted from the notes to the accounts that although the details of various items of property, plant and equipment have been disclosed by the company, no disclosures regarding movement in the capital work-in-progress were given.

It was viewed that since the capital work in progress is also the part of property, plant and equipment therefore, the amount of expenditure recognized in the carrying amount of capital-work-in-progress should have been disclosed by the company in line with the above-stated requirement of paragraph 74(b) of Ind AS 16.

3. **Depreciation on Investment Property**

Case:

In the note to the financial statements of a company on Investment Properties, disclosure of investment properties was given. Depreciation on investment properties was not charged in the reporting year but the depreciation on such investments properties was charged during the comparative year.

Principle: Ind AS 40, Investment Property

Paragraph 79 – Disclosure

"79. In addition to the disclosures required by paragraph 75, an entity shall disclose:

(a) the depreciation methods used;

(b) the useful lives or the depreciation rates used;

(c) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period;

(d) a reconciliation of the carrying amount of investment property at the beginning and end of the period, showing the following:

  (i) additions, disclosing separately those additions resulting from acquisitions and those resulting from subsequent expenditure recognised as an asset;

  (ii) additions resulting from acquisitions through business combinations;

  (iii) assets classified as held for sale or included in a disposal group classified as held for sale in accordance with Ind AS 105 and other disposals;"

Observation:

It was noted that the company has investment properties, but the depreciation has not been charged on these properties during the reporting year.

It was viewed that as per the principles of Ind AS 40, an investment property is measured initially at cost. Under the cost model, investment property is measured at cost less accumulated depreciation and any accumulated impairment losses and fair value is disclosed in notes to accounts. Hence, depreciation should have been charged on these properties and debited to Statement to Profit and Loss.

Accordingly, it was viewed that the requirements of Ind AS 40 have not been complied with in the given case.

4. Incorrect disclosure of Investment in shares

Case:

It was noted that investment in shares of listed and unlisted companies have been shown by the company under 'Inventories' in its financial statements. It was further noted that this company is not an investment company.

Principle: Ind AS 32, Financial Instruments Presentation

Paragraph 11 – Definitions

"The following terms are used in this Standard with the meanings specified:

A financial asset is any asset that is:

a) cash;

b) an equity instrument of another entity;

c) a contractual right:

  i. to receive cash or another financial asset from another entity or

  ii. to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity or

d) a contract that will or may be settled in the entity's own equity instruments and is:

  i. a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or

ii. a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include puttable financial instruments classified as equity instruments in accordance with paragraphs 16A and 16B, instruments that impose on the entity an obligation to deliver to another party a rate share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 16C and 16D, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments."

Observation:

It was viewed that **investment in shares of other companies are in nature of financial assets and hence they should be shown under the head 'Financial Assets' and should have been accounted for accordingly.**

It was viewed that due to incorrect disclosure of investment in shares, inventories have been overstated and investments have been understated which does not give true picture of financial position of the company.

Accordingly, it was viewed that the requirements of Ind AS 32 have not been complied in preparation and presentation of the financial statements.

5. Accounting Policy of Inventory

Case:

The accounting policy for Inventories read as follows:

"Inventories are stated at lower of cost and fair value ....."

Principle: Ind AS 2, Inventories

Paragraph 9 – Measurement

Inventories shall be measured at the lower of cost and net realisable value.

Paragraph 6–Definition

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

Observation:

Paragraph 9 of Ind AS 2 requires that inventories should be valued at lower of cost and net realisable value. Paragraph 6 of Ind AS 2 gives definition of net realizable value (NRV) and paragraph 9 of Ind AS 113 (Fair value Measurement) defines fair value. The net realizable value is in nature different from the fair value of inventories. The net realizable value is entity-specific value whereas fair value is not entity specific. Hence, they both may not be same.

It was viewed that net realisable value of inventory refers to the net amount (estimated selling price *less* estimated cost of completion and estimated cost of sale) that an entity expects to realise from the sale of inventory in the ordinary course of business whereas the fair value reflects the price at which an orderly transaction to sell the same inventory in the principal (or most advantageous) market for that inventory would take place between market participants at the measurement date.

The inventories ought to be valued at lower of the cost or net realisable value and not the fair value.

Accordingly, it was viewed that the above stated policy on inventory valuation is not in line with the requirements of Ind AS 2.

6. **Incomplete disclosure relating to Investments in equity shares at fair value through OCI**

Case:

In the note to the financial statements of a company on Non-Current Investments, the Company had designated three investments in equity shares at Fair Value Through Other Comprehensive Income (FVTOCI).

Principle: Ind AS 107, Financial Instruments: Disclosures

Paragraph 11A– Investments in equity instruments designated at fair value through other comprehensive income

"If an entity has designated investments in equity instruments to be measured at fair value through other comprehensive income, as permitted by paragraph 5.7.5 of Ind AS 109, it shall disclose:

a) which investments in equity instruments have been designated to be measured at fair value through other comprehensive income.

b) the reasons for using this presentation alternative.

c) …."

Observation:

It was noted that the Company had designated three investments in equity shares as fair valued through OCI (FVTOCI). However, **the reason for using the FVTOCI alternative was not disclosed which is not in line with the requirement of paragraph 11A(b) of Ind AS 107**.

Accordingly, it was viewed that the requirements of Ind AS 107 have not been complied with.

7. **Disclosure relating to Joint Operations**

Case:

An abstract of a footnote in the note to the financial statements of a company on Non-Current Financial Assets reads as follows:

"Expenses under Joint operation agreement

The Company along with another company has entered into a 'Production Sharing Contract', with a Ministry, Government of India. They executed a 'Joint Operation Agreement' whereby the rights and obligations of either party vis-à-vis the above mentioned 'Production Sharing Contract' was ascertained."

Further in the footnote, the company had disclosed the details of arrangements and share of assets.

Principle: Ind AS 111, Joint Arrangements

Paragraph 20 – Joint Operations

"A joint operator shall recognise in relation to its interest in a joint operation:

(a) its assets, including its share of any assets held jointly;

(b) its liabilities, including its share of any liabilities incurred jointly;

(c) its revenue from the sale of its share of the output arising from the joint operation;

(d) its share of the revenue from the sale of the output by the joint operation; and

(e) its expenses, including its share of any expenses incurred jointly."

Observation:

It was noted from the footnote under note to the financial statements on Non-Current Financial Assets that the company had entered into a joint operation with another company and has disclosed the details of arrangements and share of assets. However, **the company did not recognise the obligation for liabilities, expenses and did not account for revenue pertaining to its joint operations.**

Accordingly, it was viewed that the requirements of Ind AS 111 have not been complied with.