Non-compliances observed in the Ind AS Financial Statements pertaining to Equity and Liabilities in Balance Sheet

Financial Statements are the paramount source in the 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. 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. The non-compliances observed by the 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, one more publication on "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. Read on...

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 based on components of financial statements i.e., Assets, Equity, Liabilities for Balance Sheet and revenue, interest income, employee benefits etc. for Statement of Profit and Loss and likewise. This article deals with the non-compliances, observed by the Board, with regard to equity and liabilities in Balance Sheet which is an important element for Ind AS financial statements.

Observations related to Equity

Classification of Treasury Shares

Contributed by the Financial Reporting Review Board of the ICAI. Comments may be sent to frrb@icai.in and eboard@icai.in

Case

Note to the financial statements of a company read as follows:

"Beneficial Interest in a Trust represent investments in company's shares, associates and other unlisted companies net off borrowings and liabilities pertaining to investment division of a company transferred to the said trust in terms of the scheme of amalgamation. Considering that the company's shares are held by an independent trust and are meant for sale in terms of the High Court order, the beneficial interest (including company's shares) has been treated as financial asset and fair valuation as required in terms of Ind AS 109 has been carried out by an independent firm of chartered accountant and the resultant decrease in value thereof, has been adjusted from other comprehensive income."

Principle: Ind AS 32, Financial Instruments Presentation

Paragraph 33– Treasury shares

"If an entity reacquires its own equity instruments, those instruments ('treasury shares') shall be deducted from equity. No gain or loss shall be recognised in profit or loss on the purchase, sale, issue or cancellation of an entity's own equity instruments. Such treasury shares may be acquired and held by the entity or by other members of the consolidated group. Consideration paid or received shall be recognised directly in equity."

Paragraph AG 36– Treasury shares

"An entity's own equity instruments are not recognised as a financial asset regardless of the reason for which they are reacquired. Paragraph 33 requires an entity that reacquires its own equity instruments to deduct those equity instruments from equity. However, when an entity holds its own equity on behalf of others, e.g., a financial institution holding its own equity on behalf of a client, there is an agency relationship and as a result, those holdings are not included in the entity's balance sheet."

Observation

It was noted that the company has beneficial interest in a Trust which represents investments in the company's own shares, associates and other unlisted companies net off borrowings and liabilities. This beneficial interest was treated as financial asset, and accordingly, fair valued as per Ind AS 109 by the company. The impact was taken to other comprehensive income.

It was viewed that effectively, **the beneficial interest in Trust which represents investments in company's own shares, is nothing but 'treasury shares', and hence should not have been recognised as financial asset rather be deducted from equity in line with the requirements of paragraph AG 36 of Ind AS 32.**

Accordingly, it was viewed that the requirements of Ind AS 32 have not been complied with.

Disclosure of Statement of Changes in Equity

Case

Financial Statements of the company comprised of Balance Sheet, Statement of Profit and Loss, Statement of Cash Flow and Notes to Accounts but Statement of Changes in Equity was not there.

Further, there was a reference given in the auditor's report that the statement of changes in equity has been audited by them although it was not forming part of the annual report.

Principle: Companies Act, 2013 and Ind AS 1

Section 2(40) of Companies Act, 2013

"Financial Statement" in relation to a company, includes—

i) a balance sheet as at the end of the financial year;

ii) a profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year;

iii) cash flow statement for the financial year;

iv) a statement of changes in equity, if applicable; and

v) any explanatory note annexed to, or forming part of, any document referred to in sub-clause (i) to sub-clause (iv):

Provided that the financial statement, with respect to One Person Company, small company and dormant company, may not include the cash flow statement;

Paragraph 10 of Ind AS 1; Presentation of Financial Statements

"10. A complete set of financial statements comprises:

(a) a balance sheet as at the end of the period;

(b) a statement of profit and loss for the period;

(c) Statement of changes in equity for the period;

(d) a statement of cash flows for the period;

(e) notes, comprising significant accounting policies and other explanatory information;

(ea) comparative information in respect of the preceding period as specified in paragraphs 38 and 38A; and

(f) a balance sheet as at the beginning of the preceding period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements in accordance with paragraphs 40A–40D."

Observation

It was noted that the company, which is preparing financial statements as per Ind AS, inter alia, is required to prepare and present the Statement of Changes in Equity.

However, in the given case, **the Statement of Changes in Equity was not prepared which is a mandatory requirement.** Further, there was a reference given in the auditor's report that the statement of changes in equity has been audited by them although it was not forming part of the annual report.

Accordingly, it was viewed that the Company has not published the complete set of financial statements which is a non-compliance of Ind AS 1 as well as Companies Act, 2013.

Disclosure of nature and purpose of each reserve under Other Equity

Case

In the notes to the financial statements of a company on Other equity, various reserves were disclosed like Revaluation Reserve and General Reserve.

Principle: Ind AS 1, Presentation of Financial Statements

Paragraph 79

"An entity shall disclose the following, either in the balance sheet or the statement of changes in equity, or in the notes:

...

(b) a description of the nature and purpose of each reserve within equity."

Note 6(D)(II)(i)(d)

It may be noted that Note 6(D)(II)(i)(d) of 'General Instructions for preparation of Balance Sheet' of Division II Schedule III to the Companies Act, 2013 requires that;

"6D. Equity

II. Other Equity:

(i) 'Other Reserves' shall be classified in the notes as-

...

(d) Other (specify the nature and purpose of each reserve and the amount in respect thereof);"

Observation

It was noted from the note to the financial statements on Other Equity that there are various reserves with the company, however, the nature and purpose of these reserves were not disclosed by the company.

As per the above stated requirements of Ind AS 1 and Note 6(D)(II)(i)(d) of 'General Instructions for preparation of Balance Sheet' of Division II Schedule III to the Companies Act, 2013, the nature and purpose of each reserve is required to be disclosed which was not given by the company.

Accordingly, it was viewed that the requirements of Ind AS 1 and the Companies Act, 2013 have not been complied with.

Non - Current Borrowings

Case

In the note to the financial statements of a company on Non-Current Borrowings, Loans from related parties were classified as non-current. These loans from related parties were interest free and repayment terms were not stipulated.

Principle: Ind AS 1, Presentation of Financial Statements

Paragraph 60

An entity shall present current and non-current assets, current and non-current liabilities, as separate classifications in its balance sheet in accordance with paragraphs 66-76 ...

Paragraph 69

An entity shall classify a liability as current when:

...

d) it does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.

Observation

It was noted from the notes to the financial statements on Non-Current Borrowings that loans from related parties were classified as non-current. It was viewed that since loans from related parties are interest free and **repayment terms have not been stipulated, such loans are callable on demand. Therefore, the classification of such loans as non-current was not in line with the above stated requirements of Ind AS 1.**

Accordingly, it was viewed that the requirement of Ind AS 1 has not been complied with.

Financial Liabilities

Case

Abstract of an accounting policy on Financial Assets and Liabilities read as follows:

"Financial assets and liabilities

...

(v) Financial assets and liabilities at Fair Value Through Profit or Loss (FVTPL)

Financial instruments which do not meet the criteria of amortised cost or fair value through other comprehensive income are classified as fair value through profit or loss."

Principle: Ind AS 109, Financial Instruments

Paragraphs 4.2.1

"An entity shall classify all financial liabilities as subsequently measured at amortised cost..."

Paragraphs 4.2.2

"An entity may, at initial recognition, irrevocably designate a financial liability as measured at fair value through profit or loss when permitted by paragraph 4.3.5, or when doing so results in more relevant information..."

Observation

It was viewed that the stated accounting policy gives an erroneous impression that the financial instruments (including financial liabilities) can be classified as either valued at Amortised Cost or Fair Value through Other Comprehensive Income (FVOCI). However, the FVOCI classification category is not available for Financial Liabilities under Ind AS 109.

Accordingly, it was viewed that the requirements of Ind AS 109 has not been complied with in the stated policy.

Financial Liabilities

Case

In the note to the financial statements on Borrowings, various defaults in the repayment of loans were given.

Further, under paragraph (viii) of Annexure to the Auditor's Report, the auditor had reported that there has been delay in timely repayment of dues. Further, he had reported the status of payment made for these defaults, before the approval date of the financial statement.

Principle: Guidance Note on Division II- Ind AS Schedule III to the Companies Act, 2013 and Ind AS 107, Financial Instruments: Disclosures

Paragraph 8.2.3.16

"Ind AS Schedule III requires separate disclosure for default, as on the balance sheet date, in repayment of borrowings and interest but does not require any disclosure of breaches. However, para 18 of Ind AS 107 would require an entity to disclose only those breaches made during the reporting period, which permitted the lender to demand accelerated repayment and, were not remedied on or before the end of the reporting period."

Paragraph 8.2.10

"The amounts shall be classified as:

(a) Current maturities of long-term debt;

(b) ...

...

Current maturities of long-term debt

Ind AS Schedule III requires presenting 'current maturities of long-term debt' under 'Other Financial Liabilities' grouped under 'Current Liabilities'. Long term debt is specified in Ind AS Schedule III as a borrowing having a period of more than twelve months at the time of origination. However, current maturities of long-term debt are of the nature of a 'Borrowings' but since Ind AS Schedule III specifically provides a separate line item for presenting current maturities of long-term debt under Other Financial Liabilities, it is recommended that companies follow the presentation requirements of Ind AS Schedule III."

Paragraph 18 of Ind AS 107 – Defaults and breaches

"For loans payable recognised at the end of the reporting period, an entity shall disclose:

...

(c) whether the default was remedied, or the terms of the loans payable were renegotiated, before the financial statements were approved for issue."

Observation

It was observed from the note to the financial statements on Borrowings that there were various defaults in the repayment of loans. Further, under paragraph (viii) of Annexure to the Auditor's Report, the auditor had reported that there has been delay in timely repayment of dues to banks for External Commercial Borrowings (ECB) and to financial institutions for debentures. In respect of working capital facilities from Banks there has been over drawings in the accounts during the year as well as at year end. Under 'Remark' column, the auditor had reported the status of payment made for these defaults, before the approval date of the financial statement.

It was viewed that the **details of defaults remedied before the date of approval of the financial statement was not disclosed, which is not in line with the above stated requirements of paragraph 18 (c) of Ind AS 107 and paragraph 8.2.3.16 of Guidance Note** on Division II- Ind AS Schedule III to the Companies Act, 2013.

It was further noted from the note on Borrowings that **certain amount of ECB was due in the next 12 months, however, no disclosure was given for current maturities of long-term debts under current liabilities which is not in line with the above stated requirement of paragraph 8.2.10 of Guidance Note** on Division II- Ind AS Schedule III to the Companies Act, 2013.

Accordingly, it was viewed that the requirements of Ind AS 107 and Schedule III to the Companies Act, 2013 have not been complied with.