Non-compliances observed in the Ind AS Financial Statements pertaining to Statement of Cash Flows

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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. Financial Reporting Review Board (FRRB) reviews the General Purpose Financial Statements (GPFS) of enterprises with the view to identify 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 of Financial Reporting Requirements". 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 '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 of Profit and Loss and likewise. This article deals with the non-compliances, observed by the Board, with regard to Statement of Cash Flows which is an important element for Ind AS financial statements.

Observations related to Statement of Cash Flows

Re – Measurement of Defined Benefit Plan

Case

In the Cash Flow Statement of a company, the net profit before tax was used to derive cash flow from operating activities. The re-measurement of the defined benefit plan was deducted under ''Other Comprehensive Income''.

Principle: Ind AS 7, Statement of Cash Flows

Paragraph 20 – Reporting cash flows from operating activities

"Under the indirect method, the net cash flow from operating activities is determined by adjusting profit or loss for the effects of:

a) Changes during the period in inventories and operating receivables and payables;

b) Non-cash items such as depreciation, provisions, deferred taxes, unrealized foreign currency gains and losses, and undistributed profits of associates; and

c) All other items for which the cash effects are investing or financing cash flows.

Alternatively, the net cash flow from operating activities may be presented under the indirect method by showing the revenues and expenses disclosed in the statement of profit and loss and the changes during the period in inventories and operating receivables and payables."

Observation:

It was noted that re-measurement of the defined benefit plan has been deducted under ''Other Comprehensive Income (OCI)''.

It was further noted that **under The Cash Flow Statement, the net profit before tax has been used to derive cash flow from operating activities, however, ''re-measurement of the defined benefit plan'' has been adjusted here. It was viewed that since it is part of OCI, so it should not be adjusted to the net profit before tax while calculating the cash flow from operating activities.**

Accordingly, it was viewed that the requirement of Ind AS 7 has not been complied with.

Taxes on Income

Case

In the Statement of Profit and Loss of a company, income tax expense relating to the current year and tax adjusted for earlier years was shown. The exact amount was disclosed by the company as income tax paid in its cash flow statement.

Principle: Ind AS 7, Statement of Cash Flows

Paragraph 35 – Taxes on income

"Cash flows arising from taxes on income shall be separately disclosed and shall be classified as cash flows from operating activities unless they can be specifically identified with financing or investing activity."

Paragraph 36

"Taxes on income arise on transactions that give rise to cash flows that are classified as operating, investing or financing activities in a statement of cash flows. While tax expense may be readily identifiable with investing or financing activities, the related tax cash flows are often impracticable to identify and may arise in a different period from the cash flows of the underlying transaction. Therefore, taxes paid are usually classified as cash flows from operating activities. However, when it is practicable to identify the tax cash flow with an individual transaction that gives rise to cash flows that are classified as investing or financing activities the tax cash flow is classified as an investing or financing activity as appropriate. When tax cash flows are allocated over more than one class of activity, the total amount of taxes paid is disclosed."

Observation:

It was noted that the income tax expense as disclosed under Statement of Profit and Loss was the same as disclosed in the cash flow statement as income tax paid.

Considering the balances of provision for taxation and advance tax appearing in the balance sheet, it was viewed that both the amounts could not be the same. In the Statement of Cash Flow, the actual amount of income tax paid by the company should have been disclosed.

Accordingly, it was viewed that the requirements of Ind AS 7 have not been complied with.

Adjustments in Cash Flow Statement

Case

In the Cash Flow Statement of a company various adjustments were made which were not in line with the requirements of Ind AS 7.

Principle: Ind AS 7, Statement of Cash Flows

Paragraph 10– Presentation

"The statement of cash flows shall report cash flows during the period classified by operating, investing and financing activities."

Paragraph 11

"An entity presents its cash flows from operating, investing and financing activities in a manner which is most appropriate to its business. Classification by activity provides information that allows users to assess the impact of those activities on the financial position of the entity and the amount of its cash and cash equivalents. This information may also be used to evaluate the relationships among those activities."

Paragraph 44A to 44 E of Ind AS 7 – Changes in liabilities arising from financing activities

"**44A**- An entity shall provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes.

44B To the extent necessary to satisfy the requirement in paragraph 44A,an entity shall disclose the following changes in liabilities arising from financing activities:

a) Changes from financing cash flows;

b) Changes arising from obtaining or losing control of subsidiaries or other businesses;

c) The effect of changes in foreign exchange rates;

d) Changes in fair values; and

e) Other changes.

44C Liabilities arising from financing activities are liabilities for which cash flows were, or future cash flows will be, classified in the statement of cash flows as cash flows from financing activities. In addition, the disclosure requirement in paragraph 44A also applies to changes in financial assets (for example, assets that hedge liabilities arising from financing activities) if cash flows from those financial assets were, or future cash flows will be, included in cash flows from financing activities.

44D One way to fulfil the disclosure requirement in paragraph 44A is by providing reconciliation between the opening and closing balances in the balance sheet for liabilities arising from financing activities, including the changes identified in paragraph 44B. Where an entity discloses such reconciliation, it shall provide sufficient information to enable users of the financial statements to link items included in the reconciliation to the balance sheet and the statement of cash flows.

44E If an entity provides the disclosure required by paragraph 44A in combination with disclosures of changes in other assets and liabilities, it shall disclose the changes in liabilities arising from financing activities separately from changes in those other assets and liabilities."

Observation:

Following discrepancies were observed relating to the statement of Cash Flow:

a) There was no depreciation debited to the Statement of Profit and Loss, however, the same was erroneously adjusted in the cash flow statement.

b) The fair value adjustment on interest-free ICD received from the holding company was shown under cash flow from financing activities as repayment.

c) The proceeds from long term borrowings – Financial institution which was shown under cash flow from financing activities was contrary to its presentation under note on the financial liabilities where it was classified as short-term borrowing. Thus, contrary information was provided in the financial statements.

d) The Company did not disclose changes in the financing activities arising from cash and non-cash changes as required by paragraphs 44 A to 44E of Ind AS 7.

Accordingly, it was viewed that the requirements of Ind AS 7 have not been complied with.

Repayment of External Commercial Borrowings

Case

In the cash flow statement of a company, certain amount was reported as repayments of External Commercial Borrowings under the head 'Cash Flow from Financing Activities'. It was noted that the balances of 'External Commercial Borrowings' reduced from the previous year to the current year.

Principle: Ind AS 7, Statement of Cash Flows

Paragraph 43– Non-cash transactions

"Investing and financing transactions that do not require the use of cash or cash equivalents should be excluded from a cash flow statement. Such transactions should be disclosed elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities."

Observation:

It was noted from notes to the financial statements of a company on 'Non-Current Borrowings' and 'Other Current Financial Liabilities' that balances of 'External Commercial Borrowings' shown under both Non-current borrowings and Other current financial liabilities reduced from previous year to current year. As per the notes, the reduction indicated repayment during the year.

However, in the Cash Flow Statement under the head 'Cash Flow from Financing Activities', the amount of repayments of External Commercial Borrowings reported was different from what should have been done as compared to the reduction disclosed in the notes to the financial statements.

It was viewed that if the difference in the amounts reported in the cash flow statement and what should have been reported as per the notes to the financial statements were due to any repayment in a mode other than cash then the same should have been disclosed separately as required in paragraph 43 of Ind AS 7 but no such disclosure was made.

Accordingly, it was viewed that the requirements of Ind AS 7 have not been complied with.

Capital Expenditure

Case

In the cash flow statement of a company, a cash outflow was reported as 'capital expenditure' under Cash Flows from Investing Activities."

Principle: Ind AS 7, Statement of Cash Flows

Paragraph 16– Presentation

"The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which expenditures have been made for resources intended to generate future income and cash flows. Only expenditures that result in a recognized asset in the balance sheet are eligible for classification as investing activities. Examples of cash flows arising from investing activities are:

a) Cash payments to acquire property, plant and equipment, intangibles and other long-term assets. These payments include those relating to capitalized development cost and self-constructed property, plant and equipment."

Observation:

It was noted from the cash flow statement that a cash outflow has been reported as 'capital expenditure'. The capital expenditure was on account of cash paid to acquire property, plant and equipment. **It was viewed that such cash outflow should have been reported using the proper description of the line item viz. 'acquisition of property, plant and equipment' rather than as 'capital expenditure'** in line with the above mentioned requirements of paragraph 16(a) of Ind AS 7.

Accordingly, it was viewed that the description given while presenting the cash outflow on acquisition of property, plant and equipment was not in line with the above-stated requirement of Ind AS 7.

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