Non-compliances observed in the Ind AS Financial Statements pertaining to Components of Profit and Loss

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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.

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 Components of Statement of Profit and Loss which is an important element for Ind AS financial statements.

Observations related to Components of Statement of Profit and Loss

Employee Benefits – PF Contribution to a Trust

Case

Accounting policy of a company on Employee benefits read as follows:

"Defined Contribution Plans such as Provident Fund etc., are charged to the Statement of Profit and Loss Account as incurred. Further for certain employees, the monthly contribution for Provident Fund is made to a Trust

administered by the Company. The interest payable by the Trust is notified by the Government. The Company has an obligation to make good the shortfall, if any."

> **This article deals with the non-compliances, observed by the Board, with regard to Components of Statement of Profit and Loss which is an important element for Ind AS financial statements.**

Principle: Ind AS 19, Employee Benefits

Paragraph 8 – Definitions

"**Defined contribution plans** are post-employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.

Defined benefit plans are post-employment benefit plans other than defined contribution plans."

Observation:

It was noted from the stated accounting policy on employee benefits that under defined contribution plans such as provident fund, the company has an obligation to make good the shortfall, if any.

As per the definition of defined contribution plans, employer's liability to the employee is limited to the amount of contribution and has no further obligation to pay beyond agreed contribution. Further, as per the definition of defined benefit plans, employer's liability to the employee is not limited to the amount of contribution and may extend further to pay beyond agreed contribution.

Accordingly, it was viewed that if the company has an obligation to make good any shortfall, the said plan cannot be considered as defined contribution plan as per Ind AS 19.

Borrowing Cost

Case

Note to the financial statements of a company on Fair Value reads as follows:

"Amount due to/from related companies, approximate their fair values as the interest rates charged to / by related companies are approximately equivalent to interest rate prevailing in the market or re-priced regularly."

From the Related Party Disclosure, it was noted that the amount due to related party pertaining to loan was disclosed in current year as well as in previous year.

Principle: Ind AS 32, Financial Instruments

Paragraph 31-32 of Ind AS 32:

"31.

…when the initial carrying amount of a compound financial instrument is allocated to its equity and liability components, the equity component is assigned the residual amount after deducting from the fair value of the instrument as a whole the amount separately determined for the liability component. …The sum of the carrying amounts assigned to the liability and equity components on initial recognition is always equal to the fair value that would be ascribed to the instrument as a whole. No gain or loss arises from initially recognising the components of the instrument separately."

32.

… first determine the carrying amount of the liability component by measuring the fair value of a similar liability that does not have an associated equity component. The carrying amount of the equity instrument is then determined by deducting the fair value of the financial liability from the fair value of the compound financial instrument as a whole."

Observation:

It was observed that the company has not accounted for any borrowing cost (whether expensed or capitalised) in the current year as well as in the previous year. In such a case, there may be two possibilities:

(a) **Borrowing from Related Party is Interest bearing:**

In this case, the company has not accounted for the **borrowing cost** on such borrowing availed throughout the current year as well as previous year.

(b) **Borrowing from Related Party is Interest free:**

In this case, the company has not classified borrowing as **Compound Financial Instrument** in accordance with Ind AS 32. Further, according to paragraphs 31 and 32 of Ind AS 32**,** loan would include components of both Equity and Financial liability. These components should be separately recognised and accounted for in the financial statements.

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

Provision for Expected Credit Loss

Case

Under note on Trade Receivables, no provision was created for doubtful trade receivables.

Principle:-Ind AS 109, Financial Instruments

Paragraph 5.5.7 of Ind AS 109, Financial Instruments – Recognition of Expected Credit Losses

"If an entity has measured the loss allowance for a financial instrument at an amount equal to lifetime expected credit losses in the previous reporting period, but determines at the current reporting date that paragraph 5.5.3 is no longer met, the entity shall measure the loss allowance at an amount equal to 12-month expected credit losses at the current reporting date.

Paragraph 5.5.8 of Ind AS 109, Financial Instruments – Recognition of Expected Credit Losses

"An entity shall recognise in profit or loss, as an impairment gain or loss, the amount of expected credit losses (or reversal) that is required to adjust the loss allowance at the reporting date to the amount that is required to be recognised in accordance with this Standard."

Division II to the Schedule III to the Companies Act

Paragraph 6B III (ii) of General Instruction for the Preparation of Balance Sheet:

"(ii) Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.""

Observation:

It was noted from the note on trade receivables that the trade receivables have been shown as doubtful. It was viewed that when trade receivables are shown as doubtful, the company shall disclose the amount of credit loss that is expected on those receivables. **As per Ind AS 109, the company is required to recognise a loss allowance (i.e., Impairment) for expected credit losses on financial assets including trade receivables. Loss allowance is presented as separate line item as deduction from gross carrying amount of trade receivable**. It was noted that the provision for expected credit loss has not been created for doubtful trade receivables.

Accordingly, it was viewed that the requirements of Ind AS 109 as well as Division II to the Schedule III to the Companies Act, 2013 have not been complied with.

Foreign Exchange Difference

Case

Accounting policy of a company on Foreign Exchange Transaction and Translation read as follows:

"Exchange differences on monetary items receivable from or payable to a foreign operation for which settlement is neither planned nor likely to occur (therefore forming part of the investment in the foreign operation), are recognised initially in other comprehensive income (OCI) and reclassified from equity to the statement of profit and loss on repayment of the monetary items."

Principle: Ind AS 21, The Effects of Changes in Foreign Exchange Rates

Paragraph 32 – Recognition

"….. In the financial statements that include the foreign operation and

the reporting entity (e.g., consolidated financial statements when the foreign operation is a subsidiary), such exchange differences shall be recognised initially in other comprehensive income and reclassified from equity to profit or loss on disposal of the net investment in accordance with paragraph 48."

Observation:

It was noted from the stated accounting policy that the exchange difference on monetary items related to foreign operations are initially recognised in OCI and reclassified from equity to Statement of Profit and Loss on repayment of monetary items.

It was viewed that as per paragraph 32 of Ind AS 21, reclassification from equity to statement of Profit and Loss should have been made on disposal of net investment instead of reclassifying the same on repayment of the monetary items.

Accordingly, it was viewed that the requirements of Ind AS 21 have not been complied with.

Gain/ Loss on Mark to Market (MTM) transactions

Case

Abstract of accounting policy of a company on Sale of securities read as follows:

"Gain/loss from trading in derivatives has been recognised only upon settlement of trade. The Mark to Market margins have not been charged to revenue."

Principle: Ind AS 109, Financial Instruments

Paragraph 4.1.4– Classification of financial assets

"A financial asset shall be measured at fair value through profit or loss unless it is measured at amortised cost in accordance with paragraph 4.1.2 or at fair value through other comprehensive income in accordance with paragraph 4.1.2A. However an entity may make an irrevocable election at initial recognition for particular investments in equity instruments that would otherwise be measured at fair value through profit or loss to present subsequent changes in fair value in other comprehensive income."

Observation:

It was noted from the stated policy that any gain/ loss from trading in derivatives was recognised only upon settlement. Any gain/ loss on MTM (Marked to market) transactions was also not charged to the Statement of Profit and loss.

As per the requirements of Ind AS 109, all derivatives, other than those parts of hedging, which do not meet the criteria for classification as subsequently measured at Amortised Cost or Fair Value through Other Comprehensive Income (FVOCI) are measured at fair value at each reporting date and all gains and losses are recognised in the Statement of Profit or Loss.

Accordingly, it was viewed that the stated policy of the company is not in line with Ind AS 109.

Interest on prematurity of Fixed Deposits

Case

An abstract of Auditor's Report under CARO read as below:

"viii) In our opinion and according to the information and explanations given to us company has not defaulted in repayment of dues to a financial Institution or bank. During the year under consideration, the bank has charged the company on account of deduction of interest on prematurity of FDRs, which stands included under interest expense. The company has not issued debentures."

Principle: Guidance Note on Division II- Ind AS Schedule III to the Companies Act, 2013

Paragraph 9.1.8 of Guidance Note on Division II – IND AS Schedule III to the Companies Act, 2013

"The term "other operating revenue" is not defined. This would include Revenue arising from a company's operating activities, i.e., either its principal or ancillary revenue-generating

activities, but which is not revenue arising from sale of products or rendering of services. Whether a particular income constitutes "other operating revenue" or "other income" is to be decided based on the facts of each case and detailed understanding of the company's activities."

Observation:

It was noted from the CARO report of the company that deduction of interest on pre-maturity of fixed deposits was included in the finance cost. **It was viewed that the deduction of interest income on prematurity of fixed deposits should not have been accounted as finance cost, rather the interest income should not be recognised to the extent of the deduction**.

It was viewed that interest income on fixed deposits should have been shown under other income or other operating income based on the related facts of the entity.

Accordingly, it was viewed that the above stated requirements of Guidance Note on Division II – Ind AS Schedule III to the Companies Act, 2013 have not been complied with in preparation and presentation of the financial statements.

Prior Period Items

Case

In the note to the financial statements of a company on Other Expenses, Prior period items were shown during the current year and comparative year. Further, the disclosures regarding prior periods were not found in the financial statements. It was further noted that this is the entity's first Ind AS financial statement.

Principle: Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors

Paragraph 42 – Errors

"Subject to paragraph 43, an entity shall correct material prior period retrospectively in the first set of financial statements approved for issue after their discovery by:

a) restating the comparative amounts for the prior period(s) presented in which the error occurred; or

b) if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented."

Paragraph 49 – Disclosure of prior period errors

"In applying paragraph 42, an entity shall disclose the following:

a) the nature of the prior period error;

b) for each prior period presented, to the extent practicable, the amount of the correction:

   (i) for each financial statement line item affected; and

   (ii) if Ind AS 33 applies to the entity, for basic and diluted earnings per share;

c) the amount of the correction at the beginning of the earliest prior period presented; and

d) if retrospective restatement is impracticable for a particular prior period, the circumstances that led to the existence of that condition and a description of how and from when the error has been corrected.

Financial statements of subsequent periods need not repeat these disclosures."

Observation:

It was noted that the prior period items have been disclosed under the head of 'Other expenses'. It was viewed that as per Ind AS, prior period items should be adjusted either by restating the comparative amounts for the period in which error occurred or restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

In the given case, it was viewed that the company has not corrected the prior period errors retrospectively in its first set of Ind AS financial statements. Further, the disclosures as required under paragraph 49 have also not been made in the financial statements.

Accordingly, it was viewed that the requirements of Ind AS 8 have not been complied with. ■■■