Common Errors in Ind AS Financial Statements: FRRB Observations related to Expenses

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In February 2021, the FRRB issued *Study on Compliance of Financial Reporting Requirements (Ind AS Framework)* that contains instances of common non-compliances or errors in Ind AS financial statements.

In the Eleventh article of the series, we look into the FRRB observations relating to presentation and disclosure of expenses in Ind AS financial statements.

Disclosure/ Scenario in the Financial Statements selected by the FRRB	Relevant Schedule III/ Ind AS/ Companies Act requirements	FRRB Observation
1. Functional classification of Expense: In the statement of profit and loss of a company, expenses include the head 'Administrative expenses'	Ind AS 1 states as follows: *99 An entity shall present an analysis of expenses recognised in profit or loss using a classification based on the nature of expense method.*	Classification of expense based on functional classification instead of nature-wise classification as required by Ind AS 1.99. **Author's remark**: Such description of expenses shall be viewed as non-compliance with the standard. So, care should be taken to avoid such classification.

2. Cost of material consumed: The company engaged in the business of trading and manufacturing of certain goods and having its own manufacturing facility, clubbed cost of material consumed under 'Purchases of Stock in trade and Raw material' and 'Changes in Inventories of Finished goods and Stock in trade' in the Statement of Profit & Loss.	ICAI GN to Schedule III Division II *9.5 Expenses* *The aggregate of the following expenses are to be disclosed on the face of the Statement of Profit and Loss:* ♦ *Cost of materials consumed* ♦ *Purchases of Stock-in-Trade* ♦ *Changes in inventories of finished goods, work in progress and stock in trade ...* *9.5.1. Cost of materials consumed This disclosure is applicable for manufacturing companies. Materials consumed would consist of raw materials, packing materials (where classified by the company as raw materials) and other materials such as purchased intermediates and components which are 'consumed' in the manufacturing activities of the company. Where packing materials are not classified as raw materials the consumption thereof should be disclosed separately. However, intermediates and components which are internally manufactured are to be excluded from the classification:*	Cost of materials consumed has not been disclosed separately, instead clubbed with 'Purchases of Stock in trade and Raw material' and 'Changes in Inventories of Finished goods and Stock in trade'. Therefore, requirements of ICAI GN were not met.
3. **Accounting policy on Purchases:** In the financial statements, there was an accounting policy on Purchases under Revenue Recognition section.	Ind AS 1 paragraph 7 states as follows: *Information is obscured if it is communicated in a way that would have a similar effect for primary users of financial statements to omitting or misstating that information. The following are examples of circumstances that may result in material information being obscured:-* (a) *information regarding a material item, transaction or other event is disclosed in the financial statements but the language used is vague or unclear;* (b) *information regarding a material item, transaction or other event is scattered throughout the financial*	It was viewed that the purpose and relevance of disclosure of policy on 'Purchases' under the head Revenue recognition is not clear. **Author's remarks**: Care should be taken to avoid such presentation errors.

	statements; (c) *dissimilar items, transactions or other events are inappropriately aggregated;* (d) *similar items, transactions or other events are inappropriately disaggregated; and* (e) *the under standability of the financial statements is reduced as a result of material information being hidden by immaterial information to the extent that a primary user is unable to determine what information is material.*	
4. **Employee benefit policy:** It was the company provided following accounting policy on employee benefits: "Defined contribution plans such as, provident fund etc. are charged to Statement of Profit & Loss Account are 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"	Ind AS 19 provides following 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.*	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. **Author's Remarks**: Classification of PF plan under Ind AS 19/ AS 15 should be appropriately done, when the scheme is administered through the Company's own trust. One may also refer to the financial statements of leading companies where there are PF trusts.
5. **Employee benefit policy:** It was the company provided following accounting policy on employee benefits: "The company does not contribute to any Gratuity Fund Scheme. The provision in respect of the defined benefit	Ind AS 19 requires following disclosures: *135 An entity shall disclose information that:* (a) *explains the characteristics of its defined benefit plans and risks associated with them (see paragraph 139);*	As per Ind AS 19, provision for gratuity should be made for all employees irrespective of whether they have completed at least five years of service or not. The company has not made any provision

plan is however made by the company and carried as a liability, to be paid out of the regular cash flows of the company. The provision is made is respect of every employee who has completed at least five years of service, as 15 days' salary for every completed year of service. The present value of the obligation is based on actuarial valuation report."	(b) *identifies and explains the amounts in its financial statements arising from its defined benefit plans (see paragraphs 140–144); and* (c) *describes how its defined benefit plans may affect the amount, timing and uncertainty of the entity's future cash flows (see paragraphs 145–147).*	for the same. **Author's Remarks**: AS 15 and Ind AS 19 are clear that the gratuity provision is to be recognised even for future gratuity payments as per the project unit credit method.
6. **Recognition of Voluntary Retirement Scheme expense** It was noted in the employee benefits accounting policy stated as follows: "Voluntary Retirement Scheme Expenditure on VRS is being charged to Statement of Profit and Loss Account as incurred."	Ind AS 19 states as follows: *165 An entity shall recognise a liability and expense for termination benefits at the earlier of the following dates:* (a) *when the entity can no longer withdraw the offer of those benefits; and* (b) *when the entity recognises costs for a restructuring that is within the scope of Ind AS 37 and involves the payment of termination benefits.*	VRS expense is recognised as incurred. Under Ind AS 19 VRS expense shall be recognised at the earlier of the following dates: (a) when the entity can no longer withdraw the offer of those benefits; and (b) when the entity recognises costs for a restructuring that is within the scope of Ind AS 37 and involves the payment of termination benefits.
7. **Non disclosure of expected contribution in defined benefit plan:** It was noted in the employee benefits disclosure, expected contribution of defined benefit plan for next financial year has not been disclosed.	Ind AS 19 states as follows: *147 To provide an indication of the effect of the defined benefit plan on the entity's future cash flows, an entity shall disclose: ....* *(b) the expected contributions to the plan for the next annual reporting period.*	The disclosure requirement of Ind AS 19.147 is not complied with. **Author's Remarks**: AS 15 and Ind AS 19 disclosures are quite extensive and can get quite painstaking for companies. The completeness of these disclosures shall be

		ensured.
8. **Non disclosure of actuarial assumption**: It was noted in the employee benefits disclosure, actuarial assumption – disclosure of mortality rate was not found.	Ind AS 19 states as follows: *144 An entity shall disclose the significant actuarial assumptions used to determine the present value of the defined benefit obligation (see paragraph 76). Such disclosure shall be in absolute terms (eg as an absolute percentage, and not just as a margin between different percentages and other variables). When an entity provides disclosures in total for a grouping of plans, it shall provide such disclosures in the form of weighted averages or relatively narrow ranges.*	The disclosure requirement of Ind AS 19.144 is not complied with. **Author's Remarks**: AS 15 and Ind AS 19 disclosures are quite extensive and can get quite painstaking for companies. The completeness of these disclosures shall be ensured.

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