CHAPTER 1

# Interim financial reporting

**This article aims to:**

Summaries the guidance provided in the education material issued by the Institute of Chartered Accountants of India (ICAI) on Ind AS 34, *Interim Financial Reporting*

Ind AS 34, *Interim Financial Reporting*, prescribes the minimum content of an interim financial report and prescribes the principles for recognition and measurement in complete or condensed financial statements for an interim period.

The Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI) has formulated an educational material on Ind AS 34, which seeks to provide guidance by way of Frequently Asked Questions (FAQs) to explain the principles enunciated in the standard. The educational material provides guidance to stakeholders on the content of an interim financial report, application of the recognition and measurement principles to an interim financial report and various other aspects related to such report.

The subsequent section discusses some of the key issues highlighted in the FAQs.

## Applicability and disclosure of compliance with Ind AS

Ind AS 34 does not mandate which entity is required to publish interim financial reports. This standard is applicable if an entity either voluntarily elects or is required to publish an interim financial report in accordance with the Indian Accounting Standards (Ind AS). Accordingly, if an entity's interim financial report states that it complies with the Ind AS, then all the requirements of Ind AS 34 must be complied with in its interim financial statements.

If an entity's interim financial report is in compliance with this standard, that fact shall be disclosed. An interim financial report shall not be considered to comply with Ind AS unless it complies with all of the requirements of this Ind AS. Therefore, an entity shall comply with accounting, recognition, measurement and disclosure requirements as specified under Ind AS 34 while preparing interim financial statements.

## Complete or condensed set of financial statements

The standard prescribes minimum components for preparation of interim financial report both, for complete set of financial statements and for a set of condensed financial statements. An entity can elect to prepare a complete set of financial statements (as described in Ind AS 1, *Presentation of Financial Statements)* in its interim financial report or condensed interim financial statements. The standard lays down a single recognition and measurement principle that applies to both, 'complete set' and 'condensed set' of the interim financial statements.

The minimum components to be disclosed in a condensed interim financial statements are as follows:

i. a condensed balance sheet

ii. a condensed statement of profit and loss

iii. a condensed statement of changes in equity

iv. a condensed statement of cash flows and

v. selected explanatory notes.

The objective of permitting an entity to present a condensed set of financial statement, is to provide an update on the latest complete set of annual financial statements. Accordingly, it shall focus on new activities, events and circumstances and shall not duplicate information that has been reported previously.

The condensed financial statements shall include, at a minimum, each of the headings and subtotals that were included in its most recent annual financial statements and the selected explanatory notes as required by this standard. Additional line items or notes shall be included if their omission would make the condensed interim financial statements misleading. Thus, for instance, it would be inappropriate to present a three-line condensed statement of cash flows showing only a total of operating, investing and financing cash flow activities as information about cash flows helps users to understand a reporting entity's operations, evaluate its financing and investing activities, assess its liquidity or solvency and interpret other information about the financial performance. Therefore, an entity shall present all the information that is relevant in understanding an entity's ability to generate cash flows and the entity's needs to utilise those cash flows in its condensed financial statements.

The goal is to ensure that an interim financial report includes all information that is considered to be relevant in understanding an entity's financial position and performance during the interim period.

## Materiality

While determining the recognition, measurement, classification, or disclosure of an item for interim financial reporting purposes, materiality shall be assessed in relation to the interim period financial data. In making assessments of materiality, it is pertinent to note that, the interim measurements may rely on estimates to a greater extent than measurements of the annual financial data.

While arriving at the materiality judgements on its interim financial report, an entity shall consider the following factors:

a. The entity should assess whether the information in the interim financial report is material in relation to the interim period financial data and not annual data.

b. The entity shall apply the materiality factors on the basis of both the current interim period data and also, whenever there is more than one interim period (e.g. in the case of quarterly reporting), the data for the current financial year-to-date.

c. The entity may consider whether to provide in the interim financial report information that is expected to be material to the annual financial statements. However, information that is expected to be material to the annual financial statements need not be provided in the interim financial report if it is not material to the interim financial report.

## Significant events and transactions and other disclosures

The interim report should be prepared in a manner that it contains all the information, explanation of events and transactions that are relevant to understand the changes in financial position and performance of the entity during the interim period. As the users of an entity's interim financial report will have access to the most recent annual financial report of that entity, it is unnecessary to present in the notes to an interim financial report relatively insignificant updates to the information that was reported in the notes in the most recent annual financial report. Paragraph 15B of Ind AS 34 provides an illustrative list of events and transactions for which disclosures would be required if they are significant.

Furthermore, paragraph 16A of Ind AS 34 provides a list of information which needs to be included in the interim financial report.

## Accounting policies

An entity shall apply the same accounting policies in its interim financial statements as those applied in its annual financial statements.

The frequency of an entity's reporting (annual, half-yearly, or quarterly) shall not affect the measurement of its annual results. Therefore, measurements for interim reporting purposes shall be made on a year-to-date basis.

As per Ind AS 34, a change in an accounting policy, other than one for which the transition is specified by a new Ind AS, should be reflected by:

a. Restating the financial statements of prior interim periods of the current financial year and the comparable interim periods of any prior financial years that will be restated in the annual financial statements in accordance with Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Error;* or

b. When it is impracticable to determine the cumulative effect at the beginning of the financial year of applying a new accounting policy to all prior periods, adjusting the financial statements of prior interim periods of the current financial year, and comparable interim periods of prior financial years to apply the new accounting policy prospectively from the earliest date practicable.

Presentation in case of change in the accounting policy:

a. **Complete interim financial statements:** Where the entity has opted to provide a complete set of interim financial statements (as described in Ind AS 1), such an entity shall present a third balance sheet i.e. balance sheet at the beginning of the comparative period when it applies a change in accounting policy retrospectively in accordance with paragraph 40A-40D of Ind AS 1.

b. **Condensed interim financial statements:** As per the minimum components of a condensed financial statements, an entity is not required to include a third balance sheet when it applies an accounting policy retrospectively. Therefore, an entity may voluntarily elect to present a third balance sheet. Where a third balance sheet has not been presented and the change in accounting policy has to be applied retrospectively, the same shall be adjusted in the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied.

## Estimates

The use of estimates is inherent in the financial reporting process be it annual or interim financial reports. However, the preparation of interim financial reports may require relatively a greater use of estimation methods in comparison with annual reporting. The measurement procedures to be followed in an interim financial report shall be designed to ensure that the resulting information is reliable and that all material financial information that is relevant to an understanding of the financial position or performance of the entity is appropriately disclosed.

**Disclosure in annual financial statements**

If an estimate has changed significantly during the final interim period of the year and the same has not been reported as separate interim financial report since it is not published for that final interim period, the entity is required to disclose the following in the notes in the annual financial statements for that year:

a. nature of estimate and

b. amount of change in estimate made in an interim period

## Recognition of assets and liabilities and their related inflows and outflows

The tests of future economic benefits that applies for recognition of an asset at the end of a financial year shall also be applied for interim financial reporting. A cost that does not meet the definition of an asset at the end of an interim period shall not be deferred in the balance sheet with the hope that the conditions will be met in future by the year-end. Similarly, a liability at the end of an interim reporting period must represent an existing obligation as at that date, in the same manner as it is recognised at the end of an annual reporting period. If the inflows or outflows with respect to revenue and expense, have already taken place, then the related revenue and expense are recognised in the balance sheet, otherwise they are not recognised. Thus, a mere intention or necessity to incur expenditure related to an event which is to take place in future is not sufficient to give rise to an obligation which meets the recognition criteria.

For example, an employer's contributions to government-sponsored insurance funds are assessed on an annual basis. During Q1 and Q2 larger amounts of payments for this contribution were made, while during the Q3 minor payments were made (since contribution is made up to a certain maximum level of earnings per employee and hence, for higher income employees, the maximum income reaches before year end). Therefore, the employer should work out an average effective contribution rate and account for the same accordingly in its interim financials.

## Reversal of impairment loss of goodwill

As stated in the above mentioned sections, as per Ind AS 34, an entity shall apply the same accounting policies in its interim financial statements as are applied in its annual financial statements.

As per Ind AS 36, *Impairment of Assets*, an entity is required to assess goodwill for impairment at the end of each reporting period, and, if required, to recognise an impairment loss at that date. Further, paragraph 124 of Ind AS 36 states an impairment loss recognised for goodwill shall not be reversed in a subsequent period.

Therefore, basis the above guidance stated by Ind AS 34 and Ind AS 36, an entity shall not reverse an impairment loss recognised in a previous interim period in respect of goodwill. With regard to reversal of impairment of intangible assets (other than goodwill), the impairment loss can be reversed if other requirements of Ind AS 36 are met.

## Recognition of income tax expense

As stated in the aforementioned sections, an entity shall apply the same accounting recognition and measurement principles in its interim financial statements as are applied in its annual financial statements. As per Ind AS 34, income tax expense (income tax expense is the aggregate amount of current tax and deferred tax) shall be recognised in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

Amounts accrued for income tax expense in one interim period may have to be adjusted in a subsequent interim period of that financial year if the estimate of the annual income tax rate changes. Therefore, in case of any change in tax rates enacted or substantively enacted in an interim period, amounts accrued for income tax expense in one interim period should be adjusted in a subsequent interim period of that financial year.

The estimated average annual effective income tax rate is required to be re-estimated on a year-to-date basis at the end of each interim reporting period. In arriving at the interim period income tax expense, jurisdiction-wise Profit Before Tax (PBT), income categories taxed at different rates need to be considered. Thus, to the extent practicable, a separate estimated average annual effective income tax rate shall be determined for each tax jurisdiction and shall be applied individually to the interim period pre-tax income of each jurisdiction. Further, if different tax rates apply to different categories of income viz. capital gain, income from profits and gains from business or profession etc. then to the extent practicable, a separate rate shall be applied to each individual category of pre-tax income.

The education material discusses various scenarios with the help of case studies under the topic of income tax to explain above mentioned principles. Some of the situation discussed are:

1. Estimating tax rate that applies to the annual estimated income
2. Change in enacted tax rate during the financial year
3. Estimating tax expense in case of profit in the first quarter but loss in the subsequent quarters
4. Calculation of estimated average annual effective income tax rate in case of differential tax slab rates
5. Carry forward of Unused (unabsorbed) tax losses
6. Different tax rates for different categories of the estimated annual accounting income
7. Impact of depreciation on income tax expense.

## Conclusion

The education material on Ind AS 34 issued by ICAI covers number of practical scenarios. However, companies while preparing interim financial reports should consider both Ind AS 34 and education material to understand the impact of the guidance under Ind AS.