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01

Accounting for payments from suppliers

The growth of e-commerce markets, the development of new platforms and tools, and changing customer demands have all influenced the interaction between retailers and suppliers in recent years. From simple rebates or incentives to complex co-operative arrangements, there are many reasons an entity might receive payments from its supplier. For example, a supplier might pay cash to a retailer in exchange for the retailer's cooperation with, or participation in, the supplier's marketing activities.

Indian Accounting Standards (Ind AS) do not contain explicit guidance on customer's accounting for payments received (or receivable) from suppliers. Thus, judgement is required to account for these payments received (or receivable). Guidance in Ind AS 115 regarding consideration paid/ payable can help in exercising this judgment.

While Ind AS 115 *Revenue from Contracts with Customers* provides specific requirements for the accounting of consideration paid (or payable) by a supplier to its customer, there is no single Ind AS, or set of requirements, that apply to customers when payments are received (or receivable) from a supplier (sometimes referred to as 'vendor allowances'). Consideration received from a supplier can take many different forms. Therefore, entities need to carefully evaluate each transaction to determine the appropriate treatment of such amounts.

Understanding the context before analyzing payments from suppliers

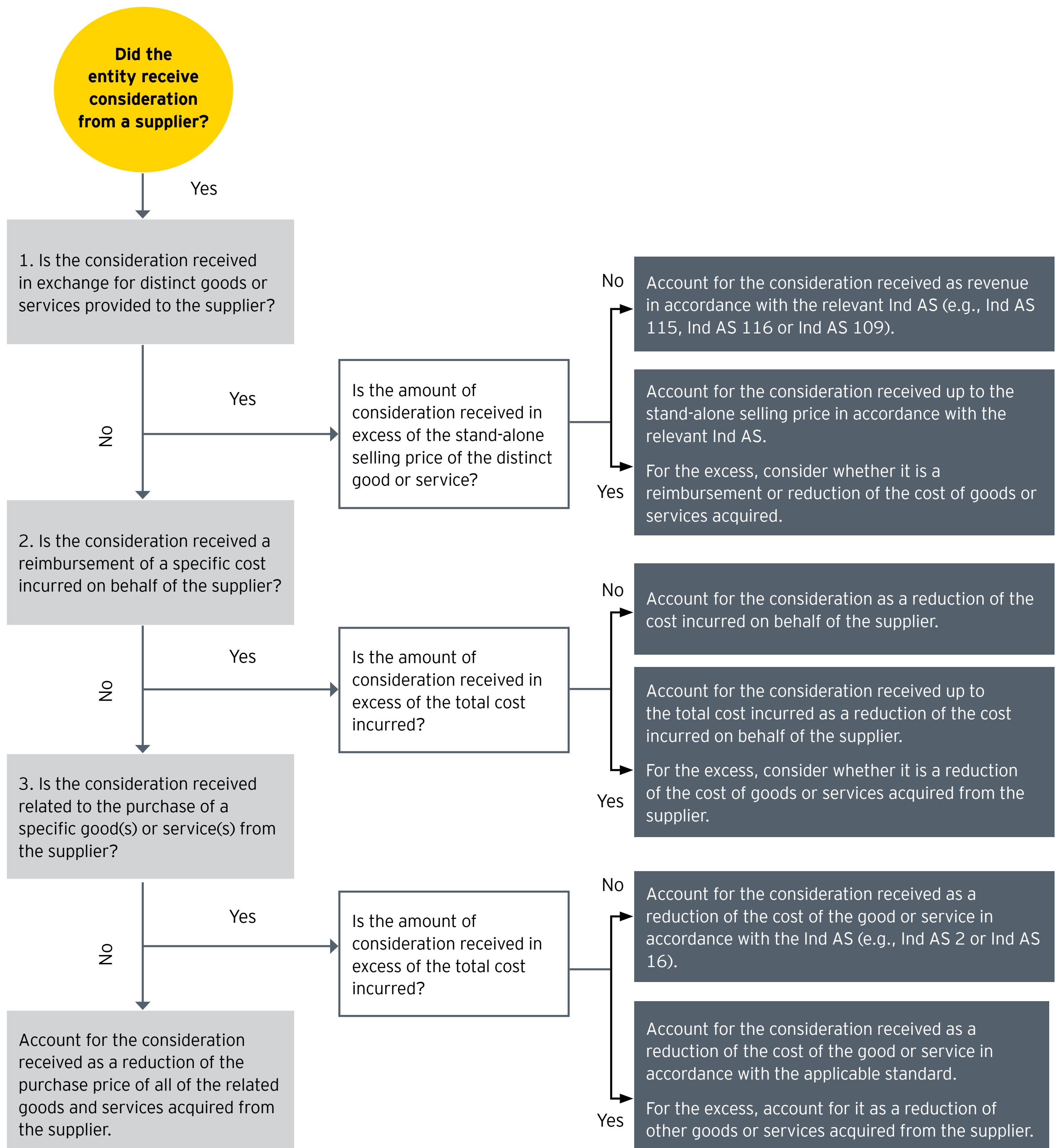
Before determning the appropriate accounting for payments from suppliers, an entity needs to understand the context of the payment and any related contract(s). To consider that context, guidance in Ind AS 115 on the following topics will be relevant:

- Combining contracts entered into at, or near, the same time with the same customer or related parties of the customer as defined in Ind AS 24 *Related Party Disclosures* (paragraph 17 of Ind AS 115)
- Considering the relevant rights and obligations in agreements that are oral or implied by the entity's customary business practice, not only terms that are written (paragraph 10 of Ind AS 115)

Considering the wider context beyond specific contractual arrangements may also be necessary, for example, if more than one supplier is involved. If payments relate to more than one supplier, entities might need to apply judgement to attribute the payments to each supplier.

Steps to apply when analyzing payments from suppliers

After determining the context of any payment, entities will need to consider requirements of multiple Ind AS and apply judgement to account for payments from suppliers. We believe there are certain key steps that will assist entities in considering relevant requirements of Ind AS and applying judgment. These steps are illustrated in the following flow chart:



As noted in these steps, the nature of a payment received from a supplier might not be clear or might be for more than one reason. Thus, judgement may be needed based upon careful consideration of the nature of the payment and the contractual relationship between the parties.

The steps are explained further below.

Step 1: Does the entity provide something distinct in exchange for the payment from the supplier?

The first step is for an entity to assess whether the payment received (or receivable) from suppliers is in exchange for a distinct good or service transferred to the supplier. Ind AS 115 provides guidance on consideration paid (or payable) to a customer from the supplier's perspective. We believe that it is appropriate for an entity, considering the requirements in Ind AS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, to apply those requirements by analogy to payments received (or receivable) from suppliers from the customer's perspective.

i) Determining whether the payment is for a distinct good or service

To determine whether the payment is in exchange for a distinct good or service, an entity is required to identify all promised goods or services, including explicit and implied promises as well as those included in other contracts or side agreements.

To determine whether the payment is in exchange for a distinct good or service that the entity transfers to the supplier (in this instance, the supplier is seen as the customer), an entity first needs to determine whether it has promised anything in exchange for the payment it has received. Conversely, it might perform administrative tasks that do not transfer a good or service to the supplier, and, therefore, there is no distinct good or service.

These promises might not be explicitly stated in the supply contract, but implied by customary practice and/ or promises included in other contracts or side agreements. Thus, an entity needs to consider all facts and circumstances to determine whether the supplier has a valid expectation that the entity is promising to provide a good or service to the supplier. If the entity identifies promised goods or services, it applies a two-step process for determining whether the promised good or service (or a bundle of goods or services) is distinct:

- Consider at the level of the individual good or service whether the supplier can benefit from the good or service on its own or with other readily available resources
- Consider whether the good or service is separately identifiable from other promises in the contract

Both of these criteria must be met to conclude that the good or service is distinct. If they are met, the individual good or service is accounted for as a separate unit of account. An entity may need to apply significant judgement to evaluate whether a distinct good or service is identifiable. For example, in some cases, any goods or services transferred to the supplier might be used by the supplier to provide goods or services to the entity, and, therefore, might not be distinct (e.g., an entity provides a tool, mould or component part to the supplier that is used to manufacture goods that the supplier sells to the entity).

ii) A distinct good(s) or service(s) is identified

If one or more distinct goods or services are identified, an entity needs to determine whether the consideration paid by the supplier exceeds the stand-alone selling prices of the goods or services provided:

- To the extent that the consideration is less than or equal to the stand-alone selling prices of the goods or services, the entity accounts for the sales or disposals of the goods or services in the same way that it accounts for provision of those goods or services to other customers or third parties, in accordance with the applicable Ind AS such as Ind AS 109 *Financial Instruments*, Ind AS 115 and Ind AS 116 *Leases*. For example, payments received from suppliers for right to use one of the customer's assets for a period of time might be within the scope of Ind AS 116 and payments for the issuance of financial instruments might be in the scope of Ind AS 109. If the distinct goods or services are not part of the entity's ordinary operating activities, they could be disposals of property, plant and equipment or intangible assets, which would be accounted for in line with Ind AS 16 or Ind AS 38, respectively.
- For any excess above the stand-alone selling prices, entities need to perform further analysis to determine whether that excess represents a reimbursement of costs incurred on behalf of a supplier or is a reduction of the purchase price of any goods or services acquired from the supplier.

Entities need to identify whether the payment received (or receivable) is in exchange for a distinct good or service transferred to the supplier and whether payment made reflects fair value of the good or service. If so, entities account for it in the same way they would account for other similar sales or disposals of goods or services.

Illustration 1-1 — Market research service

Retailer A enters into an agreement to perform a significant amount of market research for Supplier B related to the launch of a new product. Supplier B believes that it is paying for the expertise and knowledge available from Retailer A. Retailer A believes Supplier B is electing to purchase its knowledge of the market rather than internally developing such knowledge. Retailer A regularly offers such services to its customers (including non-suppliers).

Based on an evaluation of the circumstances, the cash consideration received is in return for Retailer A providing distinct services to Supplier B, viz., market research services. By using guidance in Ind AS 115 for identifying performance obligations, these services are determined to be capable of being distinct (because the market research is regularly sold separately to non-suppliers), as well as sufficiently separable from Retailer A's purchases of Supplier B's goods. Considering these and related aspects, Retailer A determines that market research is distinct within the context of the contract.

The cash consideration received from Supplier B therefore needs to be accounted for as revenue in accordance with Ind AS 115, provided that the cash consideration received does not exceed the stand-alone selling price of the distinct services received by Supplier B.

If the amount of cash consideration paid by Supplier B exceeds the stand-alone selling price of the distinct services, Retailer A would need to perform further analysis to determine whether that excess represents a reimbursement of costs incurred on behalf of Supplier B or is a reduction of the purchase price of any goods or services acquired from Supplier B.

iii) No distinct good or service is identified

If the entity does not identify a promised good or service in exchange for the payment from the supplier (either because there is no promise or because it is not distinct), it considers whether the supplier is reimbursing the entity for costs incurred on its behalf or the payment is a discount or rebate on goods or services purchased from the supplier.

Illustration 1-2 — Slotting fees

A supermarket receives fees to place a supplier's goods prominently on its shelves (and not a particular shelf). Such fees are often referred to as slotting fees. The supermarket is not required to provide the supplier with any other goods or services in exchange for the payment.

The supermarket concludes the payment it has received is not in exchange for a distinct good or service it provides to the supplier. Therefore, it moves to Step 2 to determine whether the supplier is reimbursing the entity for costs incurred on its behalf or the payment is a discount or rebate on goods or services purchased from the supplier.

Step 2: Is the supplier reimbursing the entity for costs incurred on its behalf?

An entity first needs to understand the nature of the reimbursement negotiated between the entity and the supplier and the entity should consider all facts and circumstances.

i) Determining whether the payment is a reimbursement

An entity could receive a payment from the supplier for reimbursement of costs incurred on the supplier's behalf. In some cases, this might indicate the entity is acting on behalf of the supplier as its agent. In other cases, an entity could enter into a contract with the supplier to pay certain amounts to end-consumers (the supplier's customers' customers) in advance and receive payments from the supplier for reimbursement of the amount it paid. Therefore, an entity first needs to understand the nature of the reimbursement negotiated between the entity and the supplier and the entity should consider all facts and circumstances.

Ind ASs do not contain detailed guidance on payments received for reimbursement of costs incurred on the supplier's behalf, but factors to consider may include, but are not limited to:

- Whether there is a specific agreement with the supplier to incur the costs on their behalf and be reimbursed.
- Whether the costs to be reimbursed by the supplier are directly related to the activities that caused the costs.

  This might be clear if the costs are incremental (i.e., would not be incurred if the entity had not agreed to pay them on the supplier's behalf), but in other situations, it could require significant judgement. In some cases, the costs incurred might include internal costs that are directly related to the activities that are subject to reimbursement. While internal costs may be controllable costs of an entity, they might not be directly tied to consideration from the supplier. Despite this, in certain circumstances, an entity might be able to demonstrate that the internal costs would be directly related to the activities that are subject to reimbursement. For example, an entity might receive payments for making available (on a full-time basis) dedicated marketing staff to a supplier, who are instrumental in maximizing the sale of the supplier's goods. If the staff's activities focus solely on goods or services provided by the supplier and a distinct good or service is not identified, the payments (or some parts of payments) might be deducted from the personnel costs recognized in the entity's financial statements.
- Whether the payment contains a margin exceeding the amount of the costs incurred. If so, this might indicate there is a service being performed or a good provided by the entity.

In such a situation, the entity may need to reconsider Step 1 or consider whether the payment is for both a reimbursement and also in exchange for something else. For example, an entity could receive reimbursement for costs incurred in providing a good or service as the supplier's agent. On the other hand, reimbursement could be received by an entity for pass-through amounts to the customer on behalf of the supplier or the entity's margin/price protection rather than for costs incurred in the activities on the supplier's behalf.

Considering these factors, an entity needs to determine whether the payment is, in substance, a reimbursement of a supplier's cost. Often an entity may need to use judgement and this assessment should be based on the weight of evidence available.

ii) Payments that are a reimbursement of costs incurred on behalf of a supplier

If the payments are a reimbursement of costs incurred on behalf of a supplier:

- Any payment received up to, and including, the amount of costs incurred on behalf of the supplier, would be deducted from the costs recognized in the entity's financial statements.
- Any amount exceeding the costs incurred would need to be further assessed under Step 3 to determine whether it is a discount or rebate on goods or services purchased from the supplier.

If an entity receives payment as reimbursement of costs paid on behalf of the supplier, the payment offsets the expense incurred on behalf of the supplier

Illustration 2-1 — Co-operative advertising arrangements

Supermarket A sells various products purchased from multiple suppliers. Supermarket A and some suppliers enter into a co-operative advertising arrangement to make a brochure for the upcoming holiday season to advertise specific products. Supermarket A and the suppliers agree to pay some parts of the printing and delivery costs of the brochure based on the relative space of each supplier's product in the advertisement. Supermarket A assesses the payment received in accordance with Step 1 and, considering the specific facts and circumstances, concludes that it is not providing a distinct service to the suppliers. Instead, it concludes it is a reimbursement for costs incurred on behalf of the suppliers.

When Supermarket A receives payments from the suppliers for reimbursement of the costs incurred in the co-operative advertising activities on the suppliers' behalf, these payments would be deducted from the advertising costs in the financial statements of Supermarket A. This is because the advertising costs are incurred to promote the sales of the specific products (or supplier) and the costs would not be incurred if Supermarket A and the suppliers had not entered into the arrangement.

iii) Payments that are not a reimbursement of costs incurred on behalf of a supplier

If the payment does not represent a reimbursement, the entity would need to further assess the payment received under Step 3 to determine whether it is a discount or rebate on goods or services purchased from the supplier.

Illustration 2-2 — Buydowns or margin/price protection arrangements

Manufacturer B agrees to reimburse Supermarket A up to a specified amount for shortfalls in the sales price received by the entity for Manufacturer B's products. Buydowns generally do not provide a distinct good or service to Manufacturer B, nor do they reimburse Supermarket A for a directly related cost incurred in selling Manufacturer B's products. Accordingly, such payments would be a reduction of the purchase price of goods or services acquired from Manufacturer B.

Step 3: Is the payment a discount or rebate on goods or services purchased from the supplier?

If an entity receives payment from the supplier as a discount or rebate on purchased goods or services, the payment is deducted from the cost of the purchased good or service.

If the payment is not in exchange for a distinct good or service or a reimbursement of amounts paid on behalf of a supplier, the payment will generally be part of a transaction in which the entity is purchasing something from the supplier - that is, a discount or rebate on a previous or upcoming purchase.

Appropriately identifying which goods or services the payment relates to is important in determining whether an Ind AS specifically applies to such a payment, and the appropriate timing of recognition in profit or loss.

Payments should be:

- Linked to the specific purchase(s) to which it relates, if known, or
- Allocated to purchases from suppliers on a reasonable and consistent manner, to the extent that the consideration cannot be linked to a specific good(s) or service(s).

In some cases, purchases may relate to more than one supplier (e.g., co-operative advertising), and, therefore, specific attribution or allocation on a reasonable and consistent basis will be necessary.

Accounting for supplier consideration as a reduction of the cost of the purchased goods or services (applying the requirements in Ind AS 115 for consideration payable to a customer by analogy) could result in delayed recognition in the statement of profit and loss until the related goods or services are recognized in the statement of profit and loss. In some arrangements, judgement may be required in order to apply payments from suppliers to the purchased goods or services. For example, if the level of purchases is initially unknown, an entity might need to estimate the expected purchases in the future in order to allocate the payments appropriately.

If a payment is specifically linked, or allocated to a recognized asset, a number of standards may be relevant. Ind AS 2, for example, applies to inventories an entity purchases from its suppliers. Paragraph 11 of Ind AS 2 states that trade discounts, rebates and other similar items are deducted in determining the costs of purchase for the inventory. Even though payments from suppliers to customers are not explicitly addressed, the paragraph should also be understood to include cash incentives and other payments from suppliers. Such payments could come in various forms, including incentives paid that can be offset against future purchases and payments related to a specific purchase. To the extent that such payments relate to inventories that have been sold, the entity would account for them as a reduction on cost of materials consumed/ purchase of stock-in-trade.

However, in its November 2004 agenda decision, the IFRS Interpretations Committee clarified that "rebates that specifically and genuinely refund selling expenses would not be deducted from the cost of inventories". As such, an entity receiving a payment from a supplier cannot default to treating any payment from a supplier from whom it purchases inventories as a reduction. Instead, it needs to determine the nature of the payment, which might require judgement.

Illustration 3-1 — Discounts on inventories

Consider the fact pattern in Illustration 1-2 above, in which a supermarket concludes that slotting fees received are not received in exchange for a distinct good or service.

Assume that the master supply arrangement with supplier offers the supermarket discounted prices in exchange for prominence on store shelves. This discount is achieved through monthly payments and depends on the shelf position in a given month.

The supermarket determines that the nature of the payment is a discount on inventories. On that basis, it accounts for the payment as a reduction of the costs of purchase of inventories, or as a reduction of cost of materials consumed/ purchase of stock-in-trade if the inventories have already been sold.

Another Ind AS that could be applicable is Ind AS 16, as paragraph 16(a) of Ind AS 16 requires an entity to deduct trade discounts and rebates from the cost of an asset within the scope of that standard. Similarly, paragraph 27(a) of Ind AS 38 also requires an entity to deduct trade discounts and rebates from the cost of intangible assets.

If an entity concludes that the payment represents a rebate or discount on the purchase of an asset, care is needed if the payment is variable or contingent. Since Ind AS 2, Ind AS 16 and Ind AS 38 do not provide clear guidance on accounting for variable or contingent payments , there are mixed views on accounting for such payment. Further, challenges will arise if the payments are variable or contingent for reasons not within the entity or supplier's control.

Entities also need to evaluate payment received for liquidated damages from the supplier. Such damage payments are generally deducted from the cost of the asset. However, if the agreement with the supplier specifically provides liquidated damages to compensate for loss of revenue arising because of contract delays, and the basis is clearly related to income lost, then the damages received may potentially be recognised as income.

How we see it

Significant judgement will often be needed to appropriately attribute, or allocate, payments to good(s) or service(s) purchased from supplier(s). This is key to the timing of recognition. Given the judgement involved, entities may need to disclose additional information for material payments received from suppliers to assist users of financial statements

02

Power purchase agreements – lease or no lease?

Climate change is impacting natural environment, economy and society with increased frequency and intensity all over the world, including India. Heatwaves, floods, monsoons and declining groundwater reserves are some of the key environmental challenges that India is facing today. To address these challenges, India is continuously making efforts and has set aggressive sustainability goals for itself. This can be evidenced from India's commitment to the Paris Agreement made at COP26 summit in Glasgow. India has a target to halve its carbon emissions by 2030 and achieve net zero status by 2070 by deploying various climate mitigation strategies. Overall, the efforts to reduce the society's impact on climate change have never been greater.

In line with the targets at country level, corporate entities have also set targets of carbon emission reduction and becoming net zero for themselves. These entities are taking various steps to achieve these targets. One key step is to enter into long-term power purchase agreements (PPA) to secure long-term green electricity for their business. In most cases, this helps these entities not only in reduction of carbon emission, but also saving in power purchase cost.

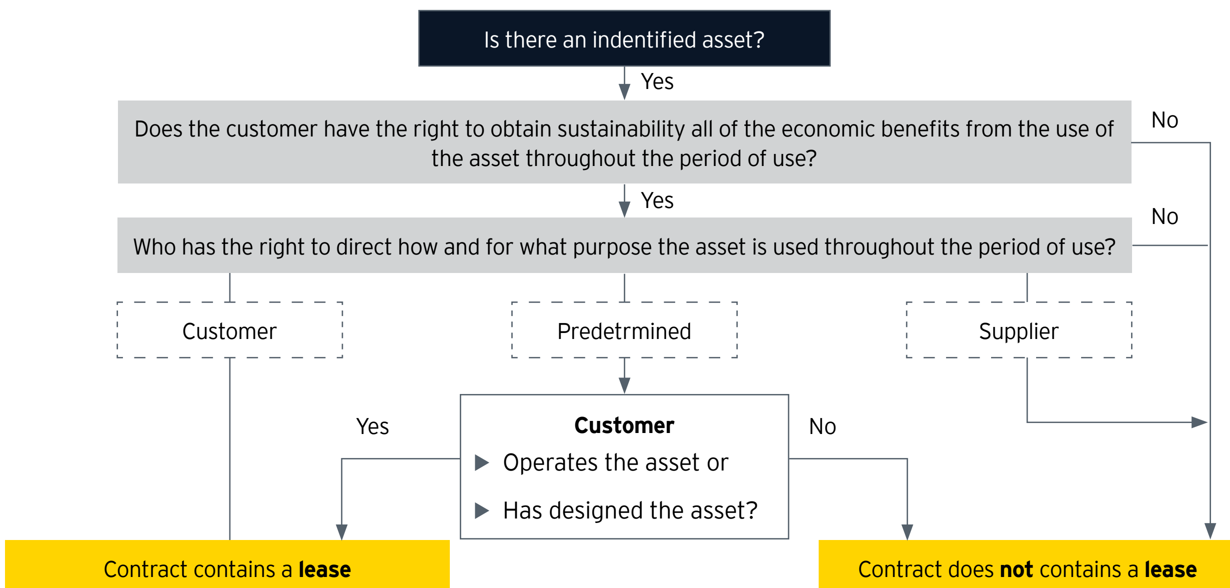
Power purchase agreements, or PPAs, are not recent developments and have been in existence for very long period of time. However, entities are increasingly entering into long-term renewable electricity contracts to secure the supply of green electricity, to obtain renewable energy certificates, if available, and to manage the price risk of renewable energy. This increased demand for PPAs is expected to increase in line with entities' commitment to becoming carbon free. The characteristics of PPAs, and unique features of renewable energy power plants particularly solar and wind plants, have resulted in entities experiencing peculiar application challenges such as whether the PPA is, or contains, lease under Ind AS 116 *Leases* and whether the PPA involves any derivative/ embedded derivative issue.

Considering unique features of solar and wind power plants, this article focuses on evaluating whether the renewal energy PPA is or contains lease under Ind AS 116. It does not deal with related or incidental issues.

Overview of lease evaluation

In accordance with Ind AS 116, a contract or part of contract that conveys the right to use of an identified asset for a period of time in exchange for consideration is a lease. The period of use is the total period of time that an asset is used to fulfil a contract with a customer (including any non-consecutive periods of time). Ind AS 116 provides principle-based definition requiring evaluation of whether an arrangement is a lease based on economic substance not merely legal form of the contract. Hence, it is possible that contracts structured as sale, purchase or service, etc. may also be identified as lease.

The below flow chart highlights key considerations in determining whether a PPA represents or contains a lease under Ind AS 116. In this evaluation, the article particularly focuses on considerations relevant to PPA for supplying power from solar or wind plant between two private parties.



Identified asset

An arrangement only contains a lease if there is an identified asset. An asset is typically identified by being explicitly specified in a contract. However, an asset can also be identified by being implicitly specified at the time that the asset is made available for use by the customer. For example, the PPA requiring power supply from one particular plant is an explicit identification of PPA. In contrast, consider one more scenario where the PPA require the supplier to supply specific amount of power produced by solar plant to the customer without specifying a particular plant. However, the supplier has only one suitable plant which can be used to supply power and it is not feasible to set-up another plant in nearby location and short period of time to supply power. In the second scenario, power plant is implicitly identified.

How we see it

Under the renewal energy PPA, plant for supplying power is generally identified.

Substantive substitution rights

Even if an asset is specified, a customer does not have the right to use an identified asset if, at inception of the contract and throughout the period of use, a supplier has the substantive right to substitute the asset. A supplier's right to substitute an asset is substantive when both of the following conditions are met:

- The supplier has the practical ability to substitute alternative assets throughout the period of use, (i.e., the customer cannot prevent the supplier from substituting an asset and alternative assets are readily available to the supplier or could be sourced by the supplier within a reasonable period of time).
- The supplier would benefit economically from the exercise of its right to substitute the asset, i.e., the economic benefits associated with substituting the asset are expected to exceed the costs associated with substituting the asset.

If the supplier has a right or an obligation to substitute the asset only on or after either a particular date, or the occurrence of a specified event, the supplier's substitution right is not substantive because the supplier does not have the practical ability to substitute alternative assets throughout the period of use.

How we see it

Under the renewal energy PPA, a supplier often does not have substitution right. Even if such right exists, it may not be substantive given the cost associated with using an alternative plant to supply power.

Rights to obtain substantially all economic benefits

To control the use of an identified asset, a customer is required to have the right to obtain substantially all of the economic benefits from use of the identified asset throughout the period of use. A customer can obtain economic benefits either directly or indirectly (e.g., by using, holding or subleasing the asset). Economic benefits include the asset's primary outputs (for example, power) and any by-products (for example, renewable energy certificates (RECs) that are generated through the use of the asset), including potential cash flows derived from these items.

However, economic benefits arising from construction or ownership of the identified asset (e.g., tax benefits related to excess tax depreciation and investment tax credits) are not considered economic benefits derived from the use of the asset. Therefore, they are not considered when assessing whether a customer has the right to obtain substantially all of the economic benefits.

How we see it

Where a customer contracts directly with the supplier to take delivery of 100% electricity (via grid or otherwise) and RECs generated from plant, the customer is likely to have right to obtain substantially all economic benefits from the use of the identified asset.

In certain cases, RECs are not given to the customer and their economic value is not substantial. Even In such cases, the customer may have right to obtain substantially all economic benefits from the use of the identified asset.

Right to direct the use of the asset

A customer has the right to direct the use of an identified asset throughout the period of use when either:

- The customer has the right to direct how and for what purpose the asset is used throughout the period of use, or
- The relevant decisions about how and for what purpose an asset is used are predetermined and the customer either: (1) has the right to operate the asset, or to direct others to operate the asset in a manner that it determines, throughout the period of use, without the supplier having the right to change those operating instructions; or (2) designed the asset, or specific aspects of the asset, in a way that predetermines how and for what purpose the asset will be used throughout the period of use.

Right to direct how and for what purpose an asset is used throughout the period of use

A customer has the right to direct the use of an identified asset where it has the right to direct how and for what purpose the asset is used throughout the period of use. When evaluating whether a purchaser has the right to direct how and for what purpose the asset is used throughout the period of use, the focus is on whether the customer has the decision-making rights that will most affect the economic benefits that will be derived from the use of the asset. The decision-making rights that are most relevant are likely to depend on the nature of the asset and the terms of the contract. Decisions about how and for what purpose an asset is used can be viewed as similar to the decisions made by a board of directors. Decisions made by a board of directors about the operating and financing activities of an entity are generally the most relevant decisions rather than the actions of individuals in implementing those decisions.

Given below are examples of decision-making rights that grant the right to change how and for what purpose an asset is used:

- The right to change the type of output that is produced by the asset, e.g., deciding whether to use a shipping container to transport goods or for storage, deciding on the mix of products sold from a retail unit
- The right to change when the output is produced, e.g., deciding when an item of machinery or a power plant will be used
- The right to change where the output is produced, e.g., deciding on the destination of a truck or a ship, deciding where a piece of equipment is used or deployed
- The right to change whether the output is produced and the quantity of that output, e.g., deciding whether to produce energy from a power plant and how much energy to produce from that power plant

It is important to note that assessment of decision-making rights is focused on those decisions that occur throughout the period of use. There may be some decisions that are predetermined in the contract. These decisions are only relevant if neither the supplier nor the customer makes any decisions about how and for what purpose the asset is used throughout the period of use.

How we see it

Given the nature of a wind or solar energy generating equipment, it is often the case that all relevant decisions are predetermined.

Predetermined decisions

In some cases, the decisions that relate to how and for what purpose the asset is used throughout the period of use are predetermined. This could be the case when the most relevant decisions about how and for what purpose an asset is used are predetermined by contractual restrictions on the use of the asset, e.g., the decisions about the use of the asset are agreed to by the customer and the supplier during the negotiation of the contract, and those decisions cannot be changed. This could also be the case when the most relevant decisions about how and for what purpose an asset is used are, in effect, predetermined by the design of the asset. For example, type of output produced by the asset, when the output is produced, where the output is produced, whether the output is produced, and the quantity of the output are pre-determined.

Where all of the relevant decisions about how and for what purposes an identified asset is used are predetermined, a customer is deemed to have the right to direct the use of an identified asset throughout the period of use when the customer either:

- Has the right to operate the asset, or direct others to operate the asset in the manner it determines, throughout the period of use without the supplier having the right to change those operating instructions, or

- Designed the asset (or specific aspects of the asset) in a way that predetermines how and for what purpose the asset will be used throughout the period of use

Normally, it will be clear from the contract whether the customer or the supplier has the right to operate and maintain the asset through-out the period of use.

The evaluation whether the customer designed the asset is likely to require entities to use significant judgement. This is for the reason that in practice, a customer may have significantly different levels of involvement of influence in design-related decisions. Generally, a customer's involvement may be restricted to some, but not all, all design-related decisions. In such case, an assessment is needed as to whether the customer made design-related decisions that most significantly affect economic benefits to be derived from the use of the asset. In practice, such decisions may vary depending on factors such as nature of the asset and technologies used. For example, for renewable energy plants, one may argue that design-related decisions most significantly affecting economic benefits from the use are:

- Selecting site location and layout,
- Determining technical functionality (e.g., overall capacity of the plant), and
- Selecting specific generating equipment (e.g., wind or solar plant) and number to be installed.

The assessment should also consider whether the customer's involvement was limited to giving broad guidelines to be considered by the supplier or the customer had an extensive involvement in establishing the design. For example, when designing a solar plant, the customer only specified its power requirement (and thereby plan capacity) and location where it needs power. Within these parameters, all other decisions such as wind plant or solar plant, number of windmills/ solar panels to be installed and exact location of the plant, were decided by the supplier. In this case, one may potentially argue that the customer had extremely limited involvement in design. However, in other circumstances, it may be necessary to consider whether broad guidelines given by the customer were specific enough to indicate that customer made design related decisions that most significantly affect economic benefits to be derived from the use of the asset.

How we see it

The evaluation whether the customer designed the asset is likely to require entities to use significant judgement. In a practical scenario, consideration of below facts may provide valuable insights in making such determination:

- Whether the supplier or the customer has greater experience and expertise in establishing and running such plants
- What are key drivers for the customer to enter into such PPA, e.g., merely to meet its power requirements or if it is also interested in running the plant
- Whether the customer has inhouse experience, expertise, or it engaged a specialist, to design power plant

Arrangements in practice

Scenario 1

- Company A (customer), engaged in the manufacturing of consumer goods, has a defined strategy to decarbonize their energy consumption. In addition, Company A considers its exposure to energy price fluctuations and the related volatility in the Statement of Profit and Loss (P&L).
- To achieve its goals relating to decarbonizing energy consumption and to reduce exposure to variable energy prices, Company A enters into a contract with a power company (Supplier) to purchase all of the electricity produced by an explicitly specified new wind farm for 20 years.
- Supplier is unable to provide power from another plant.
- Price payable for sale of power under long-term PPAs is fixed for the entire term of PPA.
- Supplier operates and maintains the wind farm on a daily basis in accordance with industry-approved operating practices.
- Considering nature of the plant, there are no decisions made as to when and how much energy is produced.
- The supplier designed and built the wind farm after entering into contract with purchaser. The customer does not have any experience/ expertise to set-up such plant and, therefore, it had no or negligible involvement in the design related decisions.

Analysis of Scenario 1 under Ind AS 116

There is an identified asset because the wind farm is explicitly specified in the contract, and the supplier does not have substantive right to substitute the specified plant.

Customer has the right to obtain substantially all of the economic benefits from use of the identified wind farm over the period (20 years) of use. Customer will take all of the power produced by the wind fam over the period of use.

However, the customer does not have the right to control the use of the wind farm because it does not have the right to direct its use. Customer does not have the right to direct how and for what purpose the plant is used. How and for what purpose the plant is used (i.e., whether when and how much power the plant will produce) is predetermined by design of the plant. Customer has no right to change how and what purpose the plant is used during the period of use. Customer did not operate the wind farm nor it was extensively involved in designing the plant. The customer rights do not extend beyond those of a customer in a typical supply or service contract.

Accordingly, in this scenario, the PPA does not contain a lease.

Scenario 2

Using the same as with scenario 1, except that plant is located in the customer premises. Also, the customer had more involvement in designing the plant, e.g., through defining number of windmills, capacity, etc. For this purpose, the customer also hired a third-party specialist. The supplier is responsible for operating and managing the plant. However, since plant is located in customer premises, it needs customer permission for the same.

Analysis of Scenario 2 under Ind AS 116:

There is an identified asset because the wind farm is explicitly specified in the contract, and the supplier does not have substantive right to substitute the specified plant.

Customer has right to obtain substantially all of the economic benefits from the use of the wind farm over the 20-year period of use. Customer has exclusive use of the wind farm and it takes all of the electricity produced by the farm.

Customer has right to control the use of the wind farm throughout the 20-year period of use because:

- Neither the customer, nor the supplier, decides how and what purpose the wind farm is used throughout the period of use because those decisions are predetermined due to design of the asset.
- Though the customer does not operate the wind farm. However, the plant is located in the customer premises and the supplier needs customer permission to enter premise for operating and managing the plant.
- The plant is located in customer premise which is one consideration for designing the asset. The customer had extensive involvement in other design aspects as well.

In this scenario, the PPA contains a lease. Customer has the right to use the wind farm for 20 years.

Way forward

Customers and suppliers entering into PPA will need to consider various aspects carefully to evaluate whether an arrangement contains a lease. Such evaluation is likely to have material accounting and disclosures consequences on financial statements of both the parties. We recommend that depending on the judgment involved, entities should consider making additional disclosures in the financial statements to apprise users regarding the significant judgement exercised by the management.

03

Accounting solutions

Capitalization of mobilization costs as costs to fulfil a contract with a customer

Fact pattern:

Mobilization costs are costs incurred by an entity to move its personnel, equipment and supplies to a project site. Mobilization costs may be incurred by an entity either before, at or after inception of a contract with a customer. Such costs are common amongst various industries/ sectors. For example, outsourcing entities often incur costs relating to the design, migration and testing of data centres when preparing to provide services under a new contract. Another example is auto component supplier entity incurring cost on designing and developing tooling prior to the production of automotive parts under an automotive supplier contract. A third example is EPC contractor incurring cost on moving personnel, equipment and supplies at the construction site.

Issues:

Can mobilization costs incurred to fulfil a contract with a customer be capitalized under Ind AS 115 *Revenue from Contracts with Customers*?

Accounting consideration:

The assessment of whether mobilization costs can be capitalized will depend on whether cost incurred is (1) within the scope of Ind AS 115; and (2) meet Ind AS 115 criteria for capitalization.

1. **Are the costs within the scope of IND AS 115?**

   As per paragraph 96 of Ind AS 115, the entity should first determine whether the mobilization costs are specifically addressed by another standard and, if so, the costs are outside the scope of Ind AS 115. Costs specifically addressed in another Ind AS (whether treated as capitalisation or expense) are covered under the respective Ind AS.

   If accounting for mobilization costs is not specifically addressed in another Ind AS or it is not clear whether these are within the scope of another Ind AS, an entity should further analyze whether the mobilization costs are:

   - Specific to the asset or applicable to more than one customer under unrelated contracts, in which case these likely would not be in the scope of Ind AS 115. For example, moving an asset between different premises of the entity to better utilize the asset in preparation for future contracts with many customers is unlikely to be covered in the scope of Ind AS 115, or
   - Specific to the contract with the customer, in which case it would be within the scope of Ind AS 115. For example, moving an asset to a remote location at the customer's request, which does not provide a benefit to the entity beyond ensuring it is in a position to fulfil its obligation(s) to the customer under the contract.

2. **Do the costs meet the criteria in paragraph 95 of Ind AS 115 to be capitalized?**

   Ind AS 115 includes three criteria that must be met for costs to fulfil a contract within its scope can be capitalized:

   A. **The costs directly relate to a contract or to an anticipated contract that the entity can specifically identify.**

      Paragraph 97 of Ind AS 115 states that:

      "Costs that relate directly to a contract include any of the following:

      a. Direct labour
      b. Direct materials
      c. Allocations of costs that relate directly to the contract or to contract activities (for example, costs of contract management and supervision, insurance and depreciation of tools, equipment and right-of-use assets used in fulfilling the contract)..."
      d. Costs that are explicitly chargeable to the customer under the contract; and
      e. Other costs that are incurred only because an entity entered into the contract (for example, payments to subcontractors)."

      Given below is an inclusive list of indicators which may suggest that a cost, by function rather than by nature is directly related to the contract:

      - The costs are explicitly or implicitly chargeable to the customer under the contract
      - The costs are incurred only because the entity entered into the contract
      - The parties to the contract explicitly or implicitly agree that the seller must move equipment etc. to a specific location

B. **The costs generate or enhance resources of the entity that will be used in satisfying performance obligations in future under the contract.**

In determining whether mobilization costs generate or enhance resources of the entity would consider the following (not limited to):

- Costs are incurred in order for the entity to be able to fulfil the contract; and
- Location is implicitly or explicitly an attribute of the contract. In simple words, the contract requires that the entity to fulfil its performance obligations at a particular location.

In addition, an entity must determine if the resource(s) will be used in satisfying or continuing to satisfy performance obligations in the future periods. Once a performance obligation is met, related fulfilment costs cannot continue to be capitalized. Hence, costs are only capitalized if they pertain to future performance. If the split between past and future performance costs is unclear and these costs do not qualify for capitalization under other Ind AS, they are expensed as incurred.

C. **The costs are expected to be recovered:**

For costs to meet the 'expected to be recovered' criterion, they need to be either explicitly reimbursable under the contract or reflected through the pricing on the contract and recoverable through margin.

Viewpoint:

We believe entities would be required to assess mobilization costs incurred to fulfil contract with customers on case-to-cases basis considering the criteria stated above. If the costs are within the scope of Ind AS 115 and fulfil all the criteria as defined above then such costs will be capitalized. This may require exercise of significant judgment.

Classification of derivatives: current vs. non-current

Fact pattern:

An entity enters in derivative contracts, potentially applying hedge accounting based on the situation and chosen accounting. Derivatives may lead to regular cash flows, a final exchange at maturity (like currency swaps and futures), or daily settlements (such as settled-to-market derivatives). Due to their daily settlement, settled-to-market derivatives are typically presented as current, assuming they have a fair value to present on the balance sheet. In certain scenarios as stated below the derivative in question is not settled through market.

a) An entity enters in a derivative for short-term price fluctuation. It is not used for hedging.

b) A derivative is entered into with the intention to hedge certain risks. Hedge accounting is not applied. The hedged item is a loan with fixed interest payments with a term of 5 years and annual payments. The derivative is a fixed-floating interest rate swap with the same life and the same notional amount and annual payments.

c) An embedded derivative is identified in a financial liability host contract. It is not considered closely related to the host contract and is accounted for separately at fair value and presented as a derivative asset or liability separately from the host financial liability. It is not held primarily for the purpose of trading.

Issues:

In what circumstances are derivative assets and liabilities are classified as current or non-current in the balance sheet?

Accounting consideration:

An asset and a liability are separated into current and non-current portions based on the guidance in paragraphs 66 and 69 of Ind AS 1 *Presentation of Financial Statements* and the applicable Division II of Schedule III of the Companies Act, 2013 (as amended).

Appendix A to Ind AS 109 *Financial Instruments* defines 'held for trading' as including a financial asset or financial liability that is a derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument).

Paragraphs 66 and 69 of Ind AS 1 require instruments held primarily for the purposes of trading being classified as current assets or liabilities. Similar requirements for current/ non-current classification are contained in Division II of Schedule III. This holds true regardless of the derivative's classification per Appendix A of Ind AS 109.

International Accounting Standards Board (IASB) clarified in paragraphs BC38I-J (Basis for conclusion) of IAS 1 that:

> *"The Board expects the criteria set out in paragraph 69 to be used to assess whether a financial liability should be presented as current or non-current. The 'held for trading' category in Appendix A of IFRS 9 is for measurement purposes and includes financial assets and liabilities that may not be held primarily for trading purposes".*

The IASB reaffirmed that if a financial liability is held primarily for trading purposes it should be presented as current regardless of its maturity date. However, a financial liability that is not held for trading purposes, such as a derivative that is not a financial guarantee contract or a designated hedging instrument, should be presented as current or non-current on the basis of its settlement date.

The above IASB clarification is issued in the context of IFRS. Since Ind AS is converged with IFRS, it is applicable for Ind AS as well.

Viewpoint:

An entity must determine whether a derivative, or separated embedded derivative, is held primarily for the purpose of trading based on the purpose for which the derivative is being held. If an instrument is held primarily for the purpose of trading, it is classified as current (irrespective of the timing of future cash flows). A derivative that is not held with the primary purpose of trading is split between current and non-current if there are any partial settlements/realizations within 12 months.

Thus, the below presentation is applied scenarios stated above:

1. Current since it is held for trading
2. The portion of the derivative that will be realized/settled in the first 12 months is classified as current, with the remaining portion classified as non-current
3. Current or non-current consistent with how the embedded derivative will be settled. The portion of the derivative that will be settled in the first 12 months is classified as current, with the remaining portion classified as non-current

04

Regulatory updates

Ministry of Corporate Affairs (MCA) updates

Listing of securities in foreign jurisdiction

The Companies (Amendment) Act, 2020 inserted subsection (3) to section 23 of the Companies Act, 2013 (the "Act") empowering the MCA to frame rules for allowing prescribed class of Indian public companies to list their securities in permissible foreign jurisdictions. It provided that "*such class of public companies may issue such class of securities for the purposes of listing on permitted stock exchanges in permissible foreign jurisdictions or such other jurisdictions, as may be prescribed*".

In October 2023, the MCA notified that the provisions of sub-section (3) will be effective from 30 October 2023. On 24 January 2024, the MCA has notified the *Companies (Listing of equity shares in permissible jurisdictions) Rules, 2024* (the "Rules") and these rules become effective from the date of their publication in the Official Gazette.

These rules allow unlisted public companies and listed public companies to issue their equity shares for the purpose of listing on permitted stock exchange in permissible jurisdictions. The companies, who have their shares listed on recognized stock exchange in India or intend to get their shares listed on recognized stock exchange in India, will also need to comply with the regulations framed or directions issued in this regard by the Securities and Exchange Board of India (SEBI). It has been clarified that the issue of equity shares for this purpose also includes offer for sale of equity shares by existing shareholders of the unlisted public company for listing on a stock exchange in a permissible jurisdiction.

However, the following categories of companies will not be eligible for such issue:

- Unlisted public company which has partly paid-up shares outstanding
- Company registered under section 8 of the Act
- Companies declared as Nidhi under section 406 of the *Act*
- Company limited by guarantee and having share capital
- Company which has any outstanding deposits accepted from the public as per Chapter V of the Act and rules made thereunder
- Company which has a negative net worth as defined under section 2(57) of the Act
- Company which has defaulted in payment of dues to any bank or public financial institution or non-convertible debenture holder or any other secured creditor. However, if the company had made good the default and a period of two years had lapsed since the date of making good the default, then the company will be eligible
- Company which has made any application for winding-up under the Act or for resolution or winding-up under the Insolvency and Bankruptcy Code, 2016 (31 of 2016) and in case any proceedings against the company for winding-up under the Act or for resolution or winding-up under the Insolvency and Bankruptcy Code, 2016 (31 of 2016) is pending
- Company which has defaulted in filing of an annual return under section 92 or financial statement under section 137 of the Act within the specified period

In accordance with the rules, permissible jurisdiction for such listing is International Financial Services Centre in India. The permitted stock exchanges are (i) India International Exchange, and (ii) NSE International Exchange.

An unlisted public company which intends to list its equity shares on permitted stock exchange in permissible jurisdiction also need to comply with "*Direct Listing of Equity Shares of Companies Incorporated in India on International Exchanges*" Scheme made by the Central Government in the Ministry of Finance. Additionally, it must file the prospectus in e-Form LEAP-1 along with the prescribed fees within a period of seven days after the same has been finalized and filed in the permitted exchange.

After the listing of equity shares on any stock exchange in permissible jurisdiction, the company needs to comply with Indian Accounting Standards (Ind AS) in preparation of their financial statements in addition to any other accounting standard, which they may be required to comply for the preparation of the financial statements filed before the securities regulator concerned, or with the stock exchange concerned, as the case may be.

What is next?

To enable direct listing of Indian Companies at GIFT- IFSC exchanges, the Department of Economic Affairs (DEA), Ministry of Finance, has amended Foreign Exchange Management (Non-debt Instruments) Rules, 2019, and notified the 'Direct Listing of Equity Shares of Companies Incorporated in India on International Exchanges Scheme'. Simultaneously, the MCA has notified the Companies (Listing of Equity Shares in Permissible Jurisdictions) Rules, 2024. These together provide an overarching regulatory framework enabling Indian public companies to issue and list their shares in permitted international exchanges in permissible jurisdictions. As of now, only unlisted public companies are allowed to list their shares as per the rules. The SEBI is in the process of issuing the operational guidelines for listed public Indian companies. We expect these guidelines to be finalized soon.

We believe these changes are a step in the right direction as they will enable Indian public companies to list their equity shares on permitted international exchanges in and tap the global markets for raising funds. Overall, it will reshape the Indian capital market landscape and offer Indian companies an alternative avenue to access global capital beyond the domestic exchanges.

Securities and Exchange Board of India (SEBI) updates

Reported information in mainstream media

The SEBI, vide *notification* no. SEBI/LAD-NRO/GN/2023/131 dated 14 June 2023, had amended Regulation 30(11) of *SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015* (*'LODR Regulations'*) requiring top 100 and 250 listed companies to confirm, clarify or deny any reported event or information in the mainstream media which is not general in nature and which indicates that rumors of an impending specific material event or information, are circulating amongst the investing public. Such confirmation, clarification or denial is required as soon as reasonably possible and not later than 24 hours from the reporting of the event or information. If the listed entity confirms the reported event or information, it will also provide the current stage of such event or information. The SEBI has also defined what constituted mainstream media in that Notification vide amendment in Regulation 2 (1)(ra).

Recently, SEBI vide *circular* dated 25 January 2024 has extended the timeline for effective implementation of Regulation 30(11) for **top 100 listed entities** by market capitalization to **01 June 2024** and for **top 250 listed entities** by market capitalization to **01 December 2024** considering the fact that the industry standards are under finalization and certain amendments to LODR Regulations are required for implementation of the aforesaid provision.

Separately, the SEBI had issued a 'Consultation Paper on Amendments to SEBI Regulations with respect to Verification of Market Rumours'. The consultation paper sought comments / views / suggestions from the public on the following broad proposals:

1. To prescribe material price movement as the criteria to verify market rumors, instead of material event in terms of regulation 30 of LODR Regulations,
2. To devise a mechanism to ensure that the unaffected price is considered with respect to transactions relating to the securities of a listed entity upon confirmation of market rumor,
3. To cast obligation on promoters, directors, key managerial personnel (KMPs) and senior management to provide adequate, accurate and timely response to the queries raised or explanation sought in respect of market rumors by the listed entity to ensure compliance with the requirement, and
4. To classify information which was not verified by listed entities as unpublished price sensitive information (UPSI)

Last date for sending comments on the Consultation Paper was 18 January 2024.

After considering the above proposals and comments received, the SEBI Board ('Board'), as its meeting held on 15 March 2024, approved below broad proposals to facilitate a uniform approach to verification of market rumours by equity listed entities. At the time of finalising this publication, final amendment to the SEBI LODR were still awaited.

- Specifying an objective and uniformly assessed criteria for rumour verification in terms of material price movement of equity shares of the listed entity
- Considering unaffected price for transactions wherever pricing norms have been prescribed under SEBI Regulations provided that the rumour pertaining to such transaction has been confirmed within twenty-four hours from the trigger of material price movement.
- Promoters, directors, key managerial personnel and senior management to provide timely response to the listed entity for verifying market rumour.
- Unverified event or information reported in print or electronic media not to be considered as 'generally available information' under *SEBI (Prohibition of Insider Trading) Regulations, 2015*.

What is next?

All investors want a fair market play. Any rumor which has a material impact on the security prices and may provide undue advantage to one set of investors needs to be curbed. At the same time, there is a need to have a clear framework for identification and confirmation of such rumors to avoid potential litigations. We welcome the SEBI move to proactively revisit the existing requirements in a manner that balances transparency and accountability with feasibility of implementation. While the final Framework that will be adopted is not yet fully clear, it seems clear that rumor verification requirement for listed companies will continue to exist. We recommend that the companies should put in place a system to gather information and rumors which are being floated in the market. In addition, companies should define a policy regarding materiality through which it could be ascertained as to which information or event is relevant and may require confirmation or denial.

Framework for Offer for Sale (OFS) of Shares to Employee through Stock Exchange Mechanism

As per the existing procedure, Offer for Sale (OFS) to employees of the eligible company is happening outside the stock exchange mechanism. The SEBI has observed that said procedure is time-consuming and also involves additional costs. Therefore, it has now decided that the promoters can also offer the shares to employees in OFS through the stock exchange mechanism.

In the context, the SEBI vide its *circular* dated 23 January 2024 has issued a framework for Offer for Sale (OFS) of shares to employees through Stock Exchange Mechanism. Under the said framework, the relevant provisions regarding offering of shares to employees by the promoters of the company have been prescribed. The procedure for OFS to employees through this mechanism is an additional option to the existing procedure of OFS to employees.

The provisions of the circular come into effect from 30th day of its issuance.

Framework for Social Stock Exchange (SSE)

The SEBI has issued a *circular* dated 28 December 2023 amending the provisions of the *framework for Social Stock Exchanges (SSE)* issued on 19 September 2022. The purpose of amendments is to protect the interests of investors and promote the development of and regulate the securities market. The circular provides guidelines and regulations for the public issuance of Zero Coupon Zero Principal Instruments by not-for-profit organizations on the Social Stock Exchange. It also specifies procedure for filing the draft fund-raising document, the minimum issue size and application size, and the minimum subscription required. The circular also outlines the conditions and requirements for the issuance of Zero Coupon Zero Principal Instruments. The circular is applicable from the date of issuance.

Institute of Chartered Accountants of India (ICAI) updates

ICAI issued revised Implementation Guide on Audit trail with additional FAQs

The ICAI has issued a revised edition of the *Implementation Guide* on Reporting on Audit Trail under Rule 11(g) of the Companies (Audit and Auditors) Rules, 2014. Among other changes, the revised edition includes 25 Frequently Asked Questions (FAQs) that addresses various practical aspects arising out of reporting requirement for the matter. The FAQs provided clarification on some important aspects such as applicability of audit trail provisions, audit trail records requiring daily backup which is to be maintained in a server physically located in India, audit trail for end user computing tools like spreadsheets, impact on reporting in case of technical glitches/limitations in the accounting software during any part of the financial year due to which audit trail feature remains non-functional.

What is next?

The management should gear up for the new reporting requirements and determine whether the existing accounting software of the company has the feature of the audit trail. The management should also evaluate whether any changes in IT configuration would be required to comply with the audit trail requirements – especially after considering the Implementation Guide of ICAI. Timely engagement with the auditors will also enable management to assess the reporting implications, both in the financial statements and in the auditor's report.

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