Year-end considerations

Updates of standards, interpretations and regulatory considerations affecting financial statements

April 2024

Click to enter

Building a better working world

We acknowledge contributions from:

- Adarsh Ranka
- Jigar Parikh
- Dr. Devesh Prakash
- Jalpa Sonchhatra
- Ayush Agrawal
- Veenit Surana
- Deepa Agarwal
- Navneet Mehta
- Darshan Varma
- Praveen K Jindal
- Pradeep Suresh
- Jayant Kumar
- Amrish Darji
- Nikita Samant
- Sajjadhussein Mistry
- Pooja Chothave
- Akshay Ramani
- Bushra S Madraswala
- Yash S Talreja
- Jeenal Nandu
- Shweta Achhra
- Natasha Mangwani
- Neha Arora
- Rashika Kewte
- Ameya Tandel
- Neha Singhal

Foreword

Economic volatility has extended through FY 2023-24, impacting various sectors globally. High core inflation, interest rates, and geopolitical tensions contribute to this instability, affecting commodity and energy prices, foreign exchange rates, and other macroeconomic factors. This situation has led to tightened credit conditions, negatively impacting consumer spending and business investments. The uncertain global economic outlook has significant implications on financial reporting, requiring entities to assess these effects on their financial statements and consider the requirement of additional disclosures for transparency and accuracy.

Companies preparing for the year-end financial reporting need to consider how these economic challenges will affect their financial statements. Regulatory changes during the year reflect many of these global challenges. The introduction of Pillar Two model rules, aiming for multinationals to pay minimum global tax, should be evaluated by companies as it could affect their tax liabilities and thus net income and cash flows. Further, transparency in climate change disclosures is required due to rising interest in environment-related risks and opportunities. Therefore, it is critical for companies to monitor these changes, allocate resources effectively, and meet evolving stakeholder and regulatory demands for robust financial reporting in the evolving economic landscape.

This publication aims to help companies make sense of the accounting and regulatory changes that are relevant for FY 2023-24 and beyond.

It is our constant endeavor to help organizations stay updated with the latest developments and changes in finance function. As companies gear up to finalize their financial statements for the year ended 31 March 2024, it is critical that they evaluate all key changes in accounting and regulatory space which impact financial and corporate reporting. This publication provides critical updates and insights to help finance leaders and teams update themselves with the changes applicable for the year-end closure and ensure that the companies are well prepared for the closure with the changes.

Purpose of this publication

This publication provides an overview of the changes in accounting standards and interpretations as well as regulatory changes up to 31 January 2024, which are relevant for financial year 2023-24 and beyond. It does not attempt to provide an in-depth analysis or discussion of the changes. Rather, it aims to highlight the key aspects of these changes.

Reference should be made to the text of the pronouncements before taking any decisions or actions. This publication consists of three sections:

Section 1 provides an overview of the key accounting changes as of 31 March 2024 and certain key amendments that are applicable for financial statements for the year-ended 31 March 2024 and beyond.

Section 2 provides a glance at the regulatory and other changes that have been issued during this year, which have a consequential impact on accounting, disclosures, and compliance with regulations.

Section 3 summarizes key hot topics which may have a significant impact on the reporting for the financial year-ended 31 March 2024 and beyond.

Hope you all find the publication useful.
Happy reading!

Adarsh Ranka
Financial Accounting Advisory Services (FAAS) Leader,
Partner with an Indian member firm of EY Global

Contents

Section 1: New accounting pronouncements relevant for financial statements of FY 2023-24 or thereafter

Section 2: Regulatory changes

Section 3: Key hot-topics

Section 1

New accounting pronouncements relevant for financial statements of FY 2023-24 or thereafter

1. Overview of key amendments to the Indian Accounting Standards (Ind AS)

Companies (Indian Accounting Standards) Amendment Rules, 2023

Background

Ministry of Corporate Affairs (MCA) vide its Notification no G.S.R. 242 (E) dated 31 March 2023 has made amendments in Companies (Indian Accounting Standards Rules), 2015, by way of exercising power under Section 133 read with Section 469 of the Companies Act, 2013, in consultation with the National Financial Reporting Authority (NFRA). Such changes were effective from annual reporting periods beginning on or after 1 April 2023. Following is the summary of key changes. There are other amendments which majorly include change in para references, substitution of words and arrangement of paragraphs in various Ind AS which have not been covered below.

Reference to standard	Key requirements	Key considerations
Ind AS 1 - Presentation of Financial Statements	The amendment in Ind AS 1 specifies that "significant accounting policies" as a component of financial statement will now be modified as "material accounting policy information". For the purpose, "Accounting policy information is material if, when considered together with other information included in an entity's financial statements, it can reasonably be expected to influence decisions that the primary users of general-purpose financial statements make on the basis of those financial statements." The amendment, through newly inserted para 117A, clarifies that accounting policy information that relates to immaterial transactions, other events or conditions is immaterial and need not be disclosed. Accounting policy information may nevertheless be material considering the nature of the related transactions, other events, or conditions, even if the amounts are immaterial. However, it is not necessary that policies pertaining to material transactions, other events or conditions are itself material. Through the newly inserted para 117B, it is mentioned that accounting policy information is expected to be material if users of an entity's financial statements would need it to understand other material information in the financial statements. The amendment by way of example explains that an entity is likely to consider accounting policy information material to its financial statements if that information relates to material transactions, other events or conditions and: a) the entity changed its accounting policy during the reporting period and this change resulted in a material change to the information in the financial statements b) the entity chose the accounting policy from one or more options permitted by Indian Accounting Standards c) the accounting policy was developed in accordance with Ind AS 8 in the absence of an Ind AS that specifically applies d) the accounting policy relates to an area for which an entity is required to make significant judgements or assumptions in applying an accounting policy, and the entity discloses those judgements or assumptions in accordance with para 122 and 125 of Ind AS 1	The replacement of 'significant' with 'material' accounting policy information in Ind AS 1 and the corresponding new guidance in Ind AS 1 may impact the accounting policy disclosures of entities. Determining whether accounting policies are material or not requires greater use of judgement. Therefore, entities are encouraged to revisit their accounting policy information disclosures to ensure consistency with the amended standard. The use of boilerplate disclosures for accounting policy information has been observed in practice. Entities should carefully consider whether "standardized information, or information that only duplicates or summarizes the requirements of the Ind AS" is material information and, if not, whether it should be removed from the accounting policies disclosures or given lower prominence to enhance the usefulness of the financial statements.

Reference to standard	Key requirements	Key considerations
	e) the accounting required for them is complex and users of the entity's financial statements would otherwise not understand those material transactions, other events, or conditions—such a situation could arise if an entity applies more than one Ind AS to a class of material transactions Through the newly added para 117C in Ind AS 1, the amendment clarifies that accounting policy information that focuses on how an entity has applied the requirements of the Indian Accounting Standards to its own circumstances which provides entity-specific information that is more useful to the users of financial statements than standardized information that only duplicates or summarizes the requirements of the Indian Accounting Standards. If in case an entity chooses to disclose immaterial accounting policies, such information shall not obscure material accounting policy information. An entity's conclusion that accounting policy information is immaterial does not affect the related disclosure requirements set out in other Indian Accounting Standards. **Consequent impact in Ind AS 107 due to amendment in Ind AS 1** In line with amendments in Ind AS 1, it is clarified that information about the measurement basis (or bases) for financial instruments used in preparing the financial statements is expected to be material accounting policy information.	
Ind AS 8 - Accounting Policies, Changes in Accounting Estimates and Errors	Amendment in Ind AS 8 brings out the definition of accounting estimate that had not been defined in the Ind AS previously and now defined as "monetary amounts in financial statements that are subject to measurement uncertainty". The amendment in para 32 of Ind AS 8 clarifies that accounting policies may require items to be measured at monetary amounts that cannot be observed directly and must instead be estimated and accounting estimates are developed to achieve the objectives set out in accounting policy. Accounting estimates are developed by using significant judgements or assumptions based on the latest available, reliable information for the entity. The amendment highlights the following examples of accounting estimates: a) a loss allowance for expected credit losses, applying Ind AS 109, financial instruments b) the net realizable value of an item of inventory, applying Ind AS 2 inventories c) the fair value of an asset or liability, applying Ind AS 113, fair value measurement d) the depreciation expense for an item of property, plant, and equipment, applying Ind AS 16 e) a provision for warranty obligations, applying Ind AS 37, provisions, contingent liabilities and contingent assets An entity uses measurement techniques and inputs to develop an accounting estimate. Measurement techniques include estimation techniques, for example, techniques used to measure a loss allowance for expected credit losses applying Ind AS 109, and valuation techniques, such as techniques used to measure the fair value of an asset or liability applying Ind AS 113. It further clarifies that the term 'estimate' in Ind AS sometimes refers to an estimate that is not an accounting estimate as defined in this standard, for e.g., it sometimes refers to an input used in developing an accounting estimate.	The pre-amended version of Ind AS 8 does not provide a definition of accounting estimates. Accounting policies, however, are defined. Furthermore, the standard defines the concept of a 'change in accounting estimates'. A mixture of a definition of one item with a definition of changes in another has resulted in difficulty in drawing the distinction between accounting policies and accounting estimates in many instances. In the amended standard, accounting estimates are now defined. This amendment mainly defines accounting estimate and states that accounting estimates are developed by the entities to achieve the objectives established in the accounting policies, thereby establishing a clear relationship between accounting estimate and accounting policy. It also clarifies that the term 'estimate' in Ind AS does not always mean accounting estimate. These amendments will provide preparers of financial statements with greater clarity as to the definition of accounting estimates, particularly in terms of the differentiation between accounting estimates and accounting policies. It also provides helpful guidance for entities in determining whether changes are to be treated as changes in estimates, changes in policies, or errors.

Reference to standard	Key requirements	Key considerations
	The amendment also clarifies that the effects on an accounting estimate of a change in an input or a change in a measurement technique are changes in accounting estimate unless they result from the correction of prior period errors.	
Ind AS 12 - Income Taxes	The amendment in Ind AS 12 has narrowed down the scope exemption on initial recognition of assets and liabilities as provided in para 22 of Ind AS 12. Accordingly, deferred tax assets and liabilities will have to be created if an equal taxable and deductible difference arises on initial recognition of assets and liabilities. The amendment clarifies that deferred tax assets or liabilities will not be created on transactions, where in the transaction does not give rise to equal taxable and deductible temporary differences. The amendment introduces para 22A in Ind AS 12, which gives an example of lease liability and right of use asset and states that at the commencement date of a lease, a lessee typically recognizes a lease liability and the corresponding amount as part of the cost of a right-of-use asset. Depending on the applicable tax law, equal taxable and deductible temporary differences may arise on initial recognition of the asset and liability in such a transaction. The initial recognition exemption as provided in para 15 and 24 of Ind AS 12 does not apply to such temporary differences and an entity recognizes any resulting deferred tax asset and liability. The above requirements are applicable for all such transactions that occur on or after the beginning of the earliest comparative period presented. The entities, at the beginning of the earliest comparative period, presented the following: a) recognize a deferred tax asset – to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilized–and a deferred tax liability for all deductible and taxable temporary differences associated with: (i) Right-of-use assets and lease liabilities (ii) Decommissioning, restoration and similar liabilities and the corresponding amounts recognized as part of the cost of the related asset b) Recognizing the cumulative effect of initially applying the amendments as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at that date. **Impact in Ind AS 101 due to amendment in Ind AS 12** Among other matters, Ind AS 101 has been amended to clarify that at the date of transition, the initial recognition exemption as mentioned in para 15 and 24 of Ind AS 12 will not be applicable to transactions associated with leases and decommissioning, restoration and similar liabilities that gives rise to equal taxable and deductible temporary differences.	The amendment limits the use of the initial recognition exemption. This is likely to improve comparability and provide more relevant information to the users of financial statements about the tax consequences of relevant transactions. The amendments could, in a few cases, lead to the recognition of unequal amounts of deferred tax assets and liabilities, despite the gross deductible and taxable temporary differences being equal. In such cases, an entity would need to account for the difference between the deferred tax asset and liability in profit or loss. The amendments provide much needed clarity on the recognition of deferred tax assets and liability on transactions, which on initial recognition, gives rise to equal taxable and deductible temporary differences, (e.g., right-of-use assets and lease liabilities). There has been diversity in practices in this area which is now been clarified via this amendment. The entities, who were earlier taking the benefit of initial recognition exemption on transactions giving rise to equal taxable and deductible temporary differences, depending on the tax law applicable, will have to carefully evaluate whether the tax deductions for payments are attributable to the asset or liability and accordingly needs to assess whether temporary differences exist on initial recognition of asset and liability.

The amendments in Ind AS 8 and Ind AS 12 provides much needed clarification in the areas of accounting estimates and deferred taxes respectively. This promotes uniformity in financial reporting across companies. Entities need to thoroughly review their accounting policies to ensure that only material accounting policies are disclosed. All these amendments require companies to re-evaluate the accounting currently followed and incorporate consequential changes carefully.

Jalpa Sonchhatra
Partner, Financial Accounting Advisory Services (FAAS), EY India

2. Summary of Key Expert Advisory Committee (EAC) opinions

A EACs covering issues relating to accounting in statement of profit and loss:

EAC-1 Accounting treatment of revenue on conversion of leasehold land to freehold land

Background

A Company is engaged in manufacturing of fertilizers. It has sold a 150 acre piece of land in exchange of (i) monetary consideration of INR 1 crore per acre and (ii) non-monetary consideration of freehold right over another land of 143 acre, which is presently held by the company as leasehold land. The Company has further stated that above specified transaction does not lack commercial substance.

While the Company had received an order from Industrial department (Kerala) granting freehold right over the 143 acres of land and there are no disputes with the said order, however, the order was not sufficient for materializing the transfer of the property into freehold since the revenue department is the ultimate competent authority for land related matters.

Accordingly, the Company recognized the revenue only to the extent of monetary compensation received in the financial year in which the transaction took place. The value of the 143 acre of land proposed to be converted as freehold was neither recognized as income nor asset, since a valid order from revenue department was not received nor the title deed was transferred to the Company. The Company stated that sale of land involves variable consideration in form of freehold rights over 143 acre of land that would be transferred only on issuance of valid order by revenue department.

After two years, the Company received a final order from revenue department granting freehold title over the land.

Issue under consideration

EAC opinion was sought on the accounting of the exchange transaction.

EAC view

EAC has noted that as per Ind AS 16 ‘Property, Plant and Equipment’ (PPE), cost of PPE acquired in an exchange transaction is measured at fair value unless the said exchange transaction lacks commercial substance or fair value of neither the asset received, nor the asset given up is reliably measurable.

In the extant case, since the exchange transaction does not lack commercial substance (as stated by the querist and presumed by the EAC) and the fair values of both the asset received and the assets given up are reliably measurable, the EAC is of the view that fair value of the assets given up, i.e., the piece of 150 acres of land and leasehold or Right of Use (ROU) of 143 acres of land (adjusted by the monetary consideration received) should form the basis of measurement of the freehold land acquired in the extant case unless the fair value of freehold land is more clearly evident. Further, as per Ind AS 16, any gain or loss arising from the derecognition of PPE shall be included in profit or loss when PPE is derecognized, however, the gains shall not be classified as ‘revenue’.

EAC has further noted that as per Ind AS 16, PPE shall be recognized only when it is probable that future economic benefits associated with an item will flow to an entity and the cost of item can be measured reliably.

EAC has noted that there was never any dispute/uncertainty with regard to Company’s entitlement to such freehold rights, rather only delay in completion of legal procedures for transfer of rights. Therefore, order, and transfer deed from revenue department cannot be considered as substantive to give rise to any uncertainty with regard to transfer of control of asset or flow of future economic benefits and are only procedural in nature in specific facts of the Company.

EAC opined that the Company should recognize the freehold land acquired in exchange transaction at the inception itself when the exchange transaction took place. However, appropriate disclosures with regard to legal title of the land should be given.

Further, EAC has also opined that promised non-monetary consideration in exchange transaction in terms of freehold land cannot be considered as variable consideration as per Ind AS 115 as it was neither a variable amount that was promised as consideration nor the Company’s entitlement to the consideration is contingent on the occurrence or non-occurrence of a future event. Accordingly, the accounting treatment as specified in background is not appropriate.

EAC-2 Recognition of miscellaneous scrap items generated in plant and scrapped assets awaiting disposal

Background

A Company is engaged in business of mining, manufacturing, generation of power at captive power plant and selling in domestic and international markets. The scrap generated at the plant is of two types: Process scrap (aluminum scraps) and Miscellaneous scrap (used spares and scrapped assets).

Process scraps are generated in the process of aluminum metal production and are re-used and not sold in the market.

Miscellaneous scraps consisting of (a) scrapped PPE that were recognized as PPE, completed its useful life and are now removed from PPE; and (b) scrapped general spares that were recognized as expenses, have no use other than selling as scrap. They are measured at every reporting date and valued at the available market price.

Sales of miscellaneous scraps are recognized as 'Other Income' and inventory of miscellaneous scrap is disclosed as 'Inventory-Scrap'.

The statutory auditors of the Company have raised an observation that cost of miscellaneous scraps has already been charged off and hence, cost of miscellaneous scraps is nil. Since the cost is nil, the miscellaneous scrap shall be valued as nil and revenue shall be recognized as income on completion of sale only. There should not be any recognition on generation of scrap.

Further, miscellaneous scrap does not fall within the definition of inventory and if the Company includes the miscellaneous scrap under inventory, then the Company should classify the revenue in 'Revenue from operations' instead of 'Other Income'.

Issue under consideration

Whether the Company's practice of recognizing miscellaneous scrap as inventory, valuing it at fair value, and recognizing income from sale/change in stock as 'Other Income' are correct.

EAC view

As per Ind AS 2, inventories are assets held for sale in the ordinary course of business, in the process of production for such sale or in the form of materials to be consumed in the production process.

EAC has opined that since miscellaneous scraps as stated above cannot be considered as finished product held for sale, or intermediate product in the process of production, or raw material to be consumed in the production process, the same does not meet the definition of inventories.

With regard to scrapped PPE, EAC has noted that as per Ind AS 16, PPE shall be derecognized either on disposal or when no future economic benefits are expected from its use or disposal. The gain or loss from derecognition shall be included in profit or loss when the item is derecognized. Since economic benefits are expected from such scrapped PPE through their disposal, the same should not be derecognized after these are scrapped. EAC has further noted that the scrapped PPE would normally appear at their residual value (as their entire economic value has already been charged to the Statement of Profit and Loss as depreciation during their useful life, subject to impairment). Therefore, the same should be continued and at the time of sale as scrap, these should be derecognized with gain or loss on sale being recognized in profit and loss. The EAC has noted that as per the Guidance Note on Division II – Ind AS Schedule III to the Companies Act, 2013, sale of PPE is not an operating activity of a company, and hence, profit on sale of PPE should be classified as 'Other income' and not 'Other operating revenue'. The Company should examine whether these scrapped items of PPE meet the classification and recognition criteria of 'non-current assets held for sale' as per Ind AS 105 'Non-current Assets Held for Sale and Discontinued Operations', in which case, these should be accounted for as per the requirements of Ind AS 105.

With regard to scrapped general spares, EAC has opined that their entire cost has already been charged off and therefore, these derecognized items should not be written back and accordingly, question of their presentation as inventories and valuation at fair value would not arise. Sale of manufacturing scrap arising from operations should be treated as other operating revenue since the same arises on account of the company's main operating activity and income on sale of such scrap should be recognized as 'other operating revenue'.

EAC-3 Accounting treatment of export incentives

Background

A Company is engaged in business of export of rolling stock and locomotives to various countries in Asia and Africa. The Company is getting incentives under Foreign Trade Policy (FTP) of Government of India. Company receives two types of export incentives viz. incentive by way of duty credit scrips, that is due on realization of export proceeds and duty drawback incentive, that is due at time of export of goods.

The Company is recognizing both the above export incentives as 'other operating income' since export incentive is directly linked with the revenue from operations of the Company.

Company's significant accounting policy on export incentives states "Export incentive is recognized when there is a reasonable assurance that the incentive will be received, and all the attached conditions have been complied with."

The Company is treating both the export incentives as government grant and accordingly provided disclosures as required under Ind AS 20.

Comptroller and Auditor General (C&AG) raised an observation that neither the significant accounting policy on export Incentives nor the disclosure made by the Company disclosed the method of presentation adopted in the financial statement. Hence, the disclosure made is deficient to that extent. Additionally, presentation made under other operating income is in contravention of requirements of Ind AS 20, which requires it to be shown under 'other income'.

Issue under consideration

EAC opinion has been sought whether export incentives as described above fall within the definition of government grant, thereby attracting disclosure requirement of Ind AS 20 and whether disclosure of export incentives as other operating income is not contravening to Ind AS 20 which requires government grant to be shown under 'Other Income'.

EAC view

EAC noted that Ind AS 20 has defined government grants as assistance by government in the form of transfers of resources in return for past or future compliance with certain conditions relating to the operating activities of the entity.

EAC has opined that the benefit of incentive either in the form of scrips or cash is received in return for compliance with certain conditions, for example, export of goods. Therefore, the benefit of incentive is a government grant as per Ind AS 20.

Ind AS 20 states that grants related to income can be presented as part of profit or loss, either separately or under a general heading such as 'Other income'; alternatively, they can be deducted in reporting the related expense.

It is further noted that as per requirements of Guidance Note on Division II- Ind AS Schedule III to the Company Act, 2013, 'other operating revenue' would include revenue arising from operating activities, but which is not revenue arising from sale of products or rendering of services; and whether a particular income constitutes 'other operating revenue' is to be decided based on the facts of each case and the nature of the company's activities.

EAC has noted that the objective of export incentive schemes essentially compensate the exporter for cost of duty/taxes paid on the inputs or materials used in exported goods and to promote export, which are essentially part of the operating activities of the Company. Further, the value of incentive is based on a specific percentage of free on board (FOB) value depending upon the specific item being exported, which indicates that the incentives in the extant case are directly linked with and arise on account of the main operations of the Company. Since the Standard allows the deduction of the grant related to income from the associated costs, this itself shows that in some cases, grants may be considered as part of operating activities.

EAC has opined that the incentives that the Company earns can be considered arising from its main business operations. Thus, the presentation of the income from government grant in the extant case as 'other operating revenue' is not inappropriate. Further, with regard to disclosures, EAC has opined that the disclosure requirements, as per Ind AS 20, should be complied with by the Company with regard to incentives in the extant case.

B EACs covering issues relating to accounting in statement of financial position:

EAC-4 Accounting treatment of subsequent expenditure as per Ind AS 16- PPE

Background

A Company is engaged in coal mining business and operates a coal washery, which was commissioned in 1986 and its useful life has already got over but is still in operation with lower capacity and major downtime. To enhance capacity and decrease downtime, a detailed report was drafted based on which, Company awarded a contract to the contractor to undertake mechanical, electrical and civil works on washery for enhancing its capacity utilization. Contractor will be responsible for four years operation and maintenance of equipment supplied after construction and handing over, under the clause of defect liability.

Company has stated that it is not following component approach as per Ind AS 16 and the entire washery is the primary unit of measure. Company has further stated that the expenditure incurred on individual part/component is insignificant as compared to the overall cost of new washery. Company has recognized incurred cost for above in profit and loss considering the following facts:

- Given the replacement activities carried out on a specific section of the washery, it is not possible to confirm future economic benefits or reliably estimate the extension of the entire plant's useful life.

Washery has lived its rated life 20 years back and there is no reliable estimation that the said repair will enhance the life of the washery. The activity of repairing is undertaken basically to improve the operation of the washery, because if the said repair improves the capacity even by 10%, then the actual expenses incurred would be recovered in a very short span of time. C&AG has raised an observation that amount incurred as above should have been capitalized under capital work-in-progress (CWIP) instead of charged in profit and loss.

Issue under consideration

EAC opinion was sought to evaluate appropriate accounting treatment and determination of useful life.

EAC view

EAC has noted that Ind AS 16 does not prescribe the unit of measurement for recognition and states that judgement is required to apply the recognition criteria to an entity's specific circumstances. Since the Company is not following component approach as per Ind AS 16 and accordingly, below evaluation relates to whole plant and not individual components. EAC is of the view that the expenditure incurred should be considered from the perspective of aggregate expenditure on washery as a whole and not in the context of expenditure incurred on individual components/parts of the washery.

EAC points out that though the querist has mentioned that the expenditure incurred on individual part/component is insignificant as compared to the overall cost of new washery. However, from accounting perspective, materiality is defined under Ind AS 1, Information is material if omitting, misstating, or obscuring it could reasonably be expected to influence decisions of primary users of financial statements.

EAC is of the view that the Company should determine whether the aggregate expenditure incurred on washery is material or not. In case the expenditure is not considered material, the same may be recognized in profit and loss.

If expenditure is considered material as per Ind AS 1, then as per Ind AS 16, PPE are tangible items that are held for use in production and are expected to be used during more than one period. Further, item of expenditure shall be recognized as an asset if, and only if it is probable that future economic benefits associated with the item will flow to the entity; and the cost of the item can be measured reliably. EAC noted from above that the recognition principle as specified above is equally applicable to costs incurred subsequently to add to, replace part of, or service an item of PPE.

EAC has noted that the cost of repair work meet definition of PPE since washery is expected to be used in continuous production for more than one period. Cost of repair work also aims to enhance the washery's operation and that even if said repair improves capacity by 10%, then actual expenses are expected to be recovered in a period of six to nine months post repair. Thus, repair work will lead to future economic benefits in terms of improvement in operations and capacity of washery. Further, since the cost incurred can be reliably measured, EAC has opined that the Company should capitalize such expenditure as cost of washery.

With regard to determination of useful life of the refurbished washery, EAC has opined that contractor's four-year maintenance agreement suggests a minimum four-year lifespan following enhancements. Further, Company should estimate asset's useful life considering technical reports, past experiences, and defect liability period and review this regularly. Reference may also be made to the requirements of Schedule II to the Companies Act, 2013 in this regard.

EAC-5 Accounting for interest income earned on fixed deposits (FD) made out of Qualified Institutional Placement (QIP) funds and QIP issue expenses.

Background

A Company is in mining business and has raised funds through QIP for capex and mine extension project. Company has also incurred issue expenses including fees and commission in connection with QIP. Company has utilized some portion of QIP funds for capex and mine expansion projects and placed the balance funds in FD. Company has been earning interest on such FD and accounting the same as other income.

C&AG is of the view that Company should adjust its QIP issue expenses with interest income and transfer the balance interest income amount to a specific reserve, as per EAC opinion in query 38 volume XXXIV.

Issue under consideration

EAC opinion has been sought as to whether the Company is correct in accounting for interest earned on the FD made out of unutilized QIP funds, as interest income. Whether the interest income earned on fixed deposit shall be taken to other income or it will be adjusted against CWIP of the above project. Whether the Company has to create the Specific Reserve as pointed out by C&AG. Whether QIP issue expenses are adjustable from the interest income as suggested by C&AG.

EAC view

As per Ind AS 16, some operations occur in connection with construction of PPE, but are not necessary to bring the PPE to location and condition necessary for it to be capable of operating in manner intended by management.

For example, income may be earned by using a building site as a car park until construction starts. Because incidental operations are not necessary to bring an item to the location and condition necessary for it to be capable of operating in a manner intended by management, the income and related expenses of incidental operations are recognized in their respective classifications of income and expense in profit and loss.

EAC has opined that pending utilization of the QIP funds which were raised for funding of mine extension i.e., capital expenditure, the same were invested in fixed deposits, which is considered as an incidental activity in connection with execution of the project, giving rise to income in the form of interest, but cannot be considered as an activity necessary to bring the project to the location and condition necessary for it to be capable of operating in manner intended by management, in accordance with Ind AS 16. Accordingly, interest income earned on FD from surplus funds should not be capitalized in the cost of project and therefore, should be continued to be recognized in other income in profit and loss in accordance with Guidance Note on Division II – Ind AS Schedule III to the Companies Act, 2013. Further, since there is no restriction on utilization of interest income, no specific reserve through appropriation of profits needs to be created.

As per Ind AS 32, transaction costs of an equity transaction shall be accounted for as a deduction from equity to the extent they are incremental costs directly attributable to the equity transaction that otherwise would have been avoided. Accordingly, EAC has opined that since QIP issue expenses appear to be the transaction costs pertaining to QIP, these should be accounted for as a deduction from equity and should be disclosed separately. Therefore, the question of adjustment of the same against the project cost does not arise.

EAC-6 Presentation of Trade Receivables realized by way of discounting of bills.

Background

A Company constructs hydropower projects and supplies electricity to the State DISCOMs. To prevent accumulation of dues and to liquidate its trade receivables, the Company enters into Bill Discounting agreements with Banks.

The bills of a DISCOM upon whom invoices for supply of power have been drawn are presented to the Bank for release of upfront payment (less interest charged). This amount is repaid to the Bank by the DISCOM in 10-12 monthly instalments. This arrangement is with recourse to the Company and in case of non-payment by the DISCOM, the Bank shall be entitled to recover the unpaid amounts along with charges, if any, from the Company. It is also pertinent to mention here that the bill discounting charges and any other charges including penal interest for overdue payment charged by the Bank are refunded by the DISCOM to the Company.

Company recognizes Short-term borrowings for the amount received from Bank by way of bill discounting. Short-term borrowing is derecognized upon repayment of liability by DISCOM. Trade Receivables which have been liquidated by way of bill discounting are presented in the Balance Sheet as ‘Current Assets - Financial Assets - Trade Receivables’ and the corresponding liability as ‘Current Liabilities - Financial Liabilities – Short-term borrowings’.

Issue under consideration

EAC opinion was sought whether presentation of trade receivables which have been liquidated by way of bill discounting as being followed by the Company is proper.

EAC view

EAC noted that as per Ind AS 109, an entity can derecognize a financial asset only when the contractual rights to cash flows from financial asset expire or it substantially transfers all risks and rewards of ownership of the financial asset.

Further, if a transfer does not result in derecognition because the entity has retained substantially all the risks and rewards of ownership of the transferred asset, the entity shall continue to recognize the transferred asset in its entirety and shall recognize a financial liability for the consideration received.

In the extant case, in case of default by the DISCOM, the Bank has full recourse to the Company for principal amount and interest as well as other incidental charges, and in that case, the Company retains the right to collect the same from the DISCOM. Therefore, apparently, the arrangement does not result in expiry of contractual cash flows from the receivables.

These terms in the view of the EAC indicate that the Company retains substantially all the risks and rewards of ownership of the receivables despite the transfer and consequently, the derecognition criteria as per Ind AS 109 are not met in respect of the trade receivables.

EAC has opined that the Company should continue to recognize the trade receivables in entirety and also recognize a financial liability for the consideration received from the Bank on discounting of the receivables.

EAC-7 Accounting treatment and disclosure of debit balance of capital reserve arising on merger

Background

A Public Limited Company has decided to merge S Ltd., a wholly owned subsidiary of the Company and T Ltd., step-down subsidiary with the Company. Both S Ltd. and T Ltd. were acquired subsidiaries. The Company had presented goodwill in respect of these subsidiaries in the consolidated financial statements (CFS) of the Company before the above merger. The Company has accounted the above merger of S Ltd. and T Ltd. with the Company under 'Common Control' transactions as per Ind AS 103, 'Business Combinations' under 'Pooling of Interest Method' and arrived at the negative capital reserve as a result of the transaction.

Issue under consideration

EAC opinion was sought whether the pre-merger consolidated goodwill shall continue to be shown in post-merger standalone financial statements (SFS) and CFS of the Company and only balance amount (i.e., the negative capital reserve net off of goodwill) should be shown as debit balance of capital reserve or full amount of negative capital reserve (without considering goodwill) shall be shown as debit balance of capital reserve.

EAC view

EAC noted, "As per Appendix C of Ind AS 103, Business Combinations, in case of common control business combinations, the assets and liabilities of the combining entities are reflected at their carrying amounts". Further, para 11 of Appendix C does not require balances of retained earnings to be recognized as per the CFS. Further para 12, inter alia, also requires that the identity of the reserves shall be preserved and shall appear in the financial statements of the transferee in the same form as they appeared in the financial statements of the transferor.

Therefore, it may be argued that Appendix C of Ind AS 103 contemplates recognizing the amounts from the SFS of the merging entities rather than the CFS. Accordingly, carrying values as appearing in the SFS of the subsidiary is to be taken; and if there is no goodwill recognized in the pre-merger financial statements of the subsidiary company and the step-down subsidiary company, no goodwill as appearing in the pre-merger CFS, should be recognized in the post-merger financial statements of the Company.

The further notes as per Issue 2 of Ind AS Technical Facilitation Group (ITFG) Bulletin 9 and the Educational Material on Ind AS 103 Business Combinations (Question 43) there is no change due to the merger of a subsidiary at consolidated group level. The merger transaction only means that the assets, liabilities and reserves of subsidiary, which were earlier appearing in the CFS before the merger, would subsequently be a part of the SFS of the parent company. ITFG further notes that separate financial statements of the parent shall be considered as a continuation of the consolidated group for the purpose of common control transaction.

Accordingly, it may not be inappropriate to recognize the carrying value of the assets, liabilities and reserves pertaining to subsidiary, as appearing in the pre-merger CFS of the parent company, in the post-merger financial statements of the parent company. In this case, the goodwill appearing in the pre-merger consolidated financial statements of the Company should be continued to be recognized in the post-merger financial statements of the Company.

On the basis of the above considerations, the EAC opined that the treatment accorded by the Company to not recognize goodwill appearing in the pre-merger CFS of the Company in the post-merger financial statements of the Company is also correct.

C EACs covering issues relating to classification/ presentation in the financial statements:

EAC-8 Classification of Lease Receivables

Background

A Company (NBFC) is engaged in the business of borrowing funds for construction of assets, which are then subsequently leased out to the Ministry of Railways (MoR). The Company was set up as dedicated financing arm of the Indian Railways for mobilizing funds from domestic as well as overseas capital markets. All its leases have been classified as finance leases.

The Company, in accordance with Ind AS 116, has been presenting lease receivables as part of receivables on the face of its Balance Sheet.

As per C&AG, in accordance with Division III - Ind AS Schedule III to the Companies Act, 2013, the said lease receivables should be presented as 'Loans' rather than 'Receivables'.

Company stated that Schedule III permits departure from requirements from Schedule III, if Ind AS requires such departure. Further, as per conceptual framework of financial reporting, for classification of assets and liabilities nature of entities' business is also to be considered. The company's perspective is that it primarily operates as a leasing company rather than a loan company. Therefore, labeling lease receivables as 'Loans' could initially suggest that the company functions as a loan provider.

Issue under consideration

EAC opinion was sought whether the presentation of 'Lease Receivables' as part of 'Receivables' on the face of Balance Sheet is in accordance with applicable Ind AS read with Division III of Schedule III to the Companies Act, 2013. If not, then what is the correct presentation?

EAC view

EAC noted that Division III of Schedule III to the Companies Act, 2013 requires the subheading ‘Loans’ under the heading ‘Financial Assets’ on the Asset side of the balance sheet to be sub-classified as under:

Loans	
(i) Leasing	
(ii) Bills purchased and bills discounted	
(iii) Others	
Total	

As per Ind AS 116, at the commencement date, a lessor shall recognize assets held under a finance lease in its balance sheet and present them as a receivable at an amount equal to the net investment in the lease.

It is noted that Division III - Schedule III to the companies Act, 2013 specifically requires to present financial assets relating to ‘Leasing’, viz., lease receivables under ‘Loans’ under the heading ‘Financial Assets’ in the Balance Sheet.

Para 67 of Ind AS 116 requires presenting net investment in lease as a receivable in the balance sheet. Therefore, the disclosure of lease receivables under ‘Loans’ as per the requirements of Schedule III cannot be considered in contradiction to or as departure from the requirements of Ind AS. Accordingly, EAC has opined that the Company should present the lease receivables under ‘Loans’ as per the requirements of Schedule III to the Companies Act, 2013.

Further, it is noted from the facts of the case that the Company’s principal business is to borrow funds for construction of assets which are then leased out to MoR. Thus, in substance, the Company is providing finance to MoR for construction of assets. Therefore, considering the nature of business of the Company also, presentation of ‘Lease Receivables’ under ‘Loans’ under the head ‘Financial Assets’ appears to be appropriate. Further, other disclosure requirements, such as maturity analysis of lease receivables as per Ind AS 116, among others, should also be complied with.

EAC-9 Presentation of cash and cash equivalents kept on behalf of clients

Background

A Company is in business of engineering consultancy. The Company engages contractor on behalf of its client and for making payment to contractor, the client deposits upfront money with the Company which is kept in designated bank accounts and funds in these banks are not freely available for normal business activities of the Company. Any interest earned on such funds is credited to client account only. The bank account is opened and operated by the Company. Since these funds are provided by clients, a suffix ‘client fund’ is attached while representing cash and bank balances in financial statements. Company’s accounting policy state that Cash and cash equivalents consist of balances with banks which are unrestricted for withdrawal and usage.

Since client funds presented as cash and bank balances are not freely available to be used for Company’s own purposes, inflow and outflow from these client funds are not considered as part of statement of cash flow.

C&AG raised an observation that above funds related to client which are earmarked for various projects have been incorrectly shown under cash and cash equivalents – client fund instead of other bank balances as per Guidance Note on Division II- Ind AS Schedule III to the Company Act, 2013.

C&AG also observed that since client funds are restricted for withdrawal and usage, the Company’s accounting policy on cash and cash equivalents is deficient to that extent since it does not disclose this fact.

Issue under consideration

EAC opinion has been sought whether significant accounting policy and disclosure made in respect of cash and cash equivalents related to client funds, and not considering the client funds in Statement of Cash Flow are as per Ind AS 7 read with Guidance Note on Division II- Ind AS Schedule III to the Company Act, 2013 and if not, what modification needs to be done.

EAC view

EAC noted that the terms of bank account in which client money is collected in advance contain no contractual restriction regarding access i.e., these funds are available on demand for use by the Company. However, as per contracts with the clients/customers, these funds are not to be used for normal business activities of the Company.

Further, Ind AS 7 requires disclosure of information about cash and cash equivalent that are not freely available for use and subject to certain restrictions. Thus, it indicates that cash or cash equivalent can be subject to restrictions on use. Accordingly, EAC is of the view that the restrictions on usage do not preclude an item from being classified as cash and cash equivalent unless it would no longer meet the definition of cash and cash equivalents due to such restrictions.

EAC opined that, in the extant case, the client funds are kept in designated accounts for period of three months or less and are not subject to any risk of changes in value. Therefore, they meet the definition of cash and cash equivalents irrespective of the purpose for which such funds can be used by Company.

The above restrictions in usage should be separately and adequately disclosed under cash and cash equivalents as per

Ind AS 7 and Guidance Note on Division II- Ind AS Schedule III to the Company Act, 2013.

Further, Guidance Note on Division II- Ind AS Schedule III to the Company Act, 2013 states that there should not be a difference in the amount of cash and cash equivalents as per Ind AS 1 and Ind AS 7. Therefore, the cash and cash equivalents presented as per statement of cash flows should also be presented under similar head in balance sheet. Also, as per the requirements of para 22 of Ind AS 7, cash flows on behalf of clients when they reflect the activities of the clients rather than those of the entity may be reported on a net basis in the Statement of Cash Flows.

EAC-10 Classification/ Presentation of amount paid for acquisition of Land as Inventory or Advance

Background

A Company operates as a real estate developer. Ghaziabad Development Authority (GDA) allotted a plot to the Company. The Company paid full consideration to GDA as per allotment letter and recognized the same as land inventory. While the conveyance deed was yet to be executed, the possession of plot could not be obtained due to raising of additional demand for infrastructure charges by GDA, which the Company did not accept.

Subsequently, the Company wrote to GDA and Principal Secretary, Housing and Urban Planning, UP for cancellation of the plot and requested to refund full consideration amount with interest to the Company. GDA has given two options: either to execute the conveyance deed after paying infrastructure surcharge or withdrawal of the allotment after deducting 10% of land consideration amount.

Issue under consideration

EAC opinion was sought as to whether the Company may continue to present the consideration paid to GDA for land acquisition as ‘Land Inventory’ or transfer the same to ‘Advance’; or any other suitable treatment is required as per the applicable Ind AS.

EAC view

EAC has noted that the Company has not canceled the allotment letter and therefore, the settlement of the contract is in terms of land only and not in terms of cash or another financial asset. It is examined that whether there exists an ‘asset’ and what the asset is, i.e., ‘land’ or ‘advance paid for land’.

According to Conceptual Framework for Financial Reporting, an asset can be recognized only when there is: (a) right; (b) potential to produce economic benefits; and (c) control over a resource.

In the extant case, the possession of the plot has not been obtained by the Company and the sale deed is yet to be executed. Thus, the Company does not have any right over the land. The Company does not have the ability to direct the use of land or to prevent other parties from obtaining benefits from the land in the absence of possession of land. Therefore, there is no potential for future economic benefits from land as an asset. Thus, the land does not meet the definition of asset and hence, the question of classifying the same as ‘Inventory’ does not arise.

Further, the advance paid to GDA gives the Company the right to receive the land on completion of necessary formalities, and therefore, advance has the potential to produce economic benefits for the Company. Therefore ‘advance paid for land’ meets the definition of ‘asset’ for the Company.

As per Ind AS 32, assets such as prepaid expenses, for which the future economic benefit is the receipt of goods or services, rather than the right to receive cash or another financial asset, are not financial assets.

Based on above, EAC has opined that since advance paid for land in the extant case will give rise to future economic benefits in the form of the receipt of land, rather than the right to receive cash, the Company should not continue to present the consideration paid to GDA as ‘Land Inventory’, rather the same should be accounted for as a non-financial asset, such as advance paid for land.

EAC-11 Presentation of standby, stoppage and allied costs incurred during force majeure in the project in the Statement of Profit and Loss

Background

A Company is in the business of exploration and production of oil and gas and other hydrocarbon related activities outside India. The Company operates overseas projects directly and/ or through subsidiaries by participation in various joint arrangements and investment in associates.

The Company has participating interest (PI) through its subsidiaries in an overseas oil and gas project (Project A). Project A is a joint operation, operated by the international oil company and Company’s subsidiaries are non-operating partners in the project. Project A is under-development stage and development activities are being undertaken by the operator. Accordingly, it is considered as under-construction production facilities as per Guidance Note on Accounting for Oil and Gas Producing Activities. Operator raises monthly cash calls from non-operating partners and provides capex statement.

The Company while acquiring participating share in the Project A, had financed the purchase consideration by way of external borrowings. Since, the said oil and gas Project A is under development, the directly associated borrowing costs were capitalized to the qualifying assets.

Force majeure was declared by Operator in Project A due to security situations. As a result, the project remained suspended during the financial year. Moreover, due to such force majeure situation, material standby, support costs and stoppage costs were incurred, such as de-mobilization, termination or cancellation fees and one-off settlement (incremental expenditures).

Company did not consider these incremental expenditures for capitalization and instead charged off the same as 'Other Expenses' in profit and loss along with an explanatory note. Company has not presented these incremental expenditures as exceptional items due to the reasons that force majeure, though material and undesirable for any business, is a common phenomenon for businesses.

Similarly, capitalization of borrowing costs for such period was suspended in view of suspension of development activities in the Project and charged off the same to profit and loss.

C&AG raised the query that these incremental costs and borrowing costs incurred during the period of suspension due to force majeure are exceptional items and should be presented under the head 'Exceptional items' in the profit and loss.

Issue under consideration

EAC opinion was sought whether the incremental costs and borrowing costs incurred during the period of suspension due to force majeure should be presented as part of 'Finance costs' or as 'exceptional item' in profit and loss.

EAC view

EAC noted that Part II of Division II - Ind AS Schedule III to the Companies Act, 2013 prescribes the format of Statement of Profit and Loss for companies adopting Ind AS, which requires presentation of 'Exceptional Items' as a separate line item in profit and loss. Further, General instructions for Preparation of Statement of Profit and Loss require disclosure by way of notes, additional information regarding 'details of items of exceptional nature'. However, exceptional item is not defined in Schedule III to the Companies Act, 2013 or Ind AS. EAC also noted that Schedule III to the Companies Act, 2013 requires presentation of finance costs as separate line item in profit and loss.

EAC noted that material items need to be presented as line items and/or disclosed in the financial statements, which includes the notes. Materiality depends on the magnitude and nature of information and an information is material if omitting or misstating or obscuring it could be expected to influence the decisions of primary users of financial statements. Further, since effects of events and transactions differ in frequency, the components of financial performance should be disclosed, and additional line items should be presented when such presentation is relevant to understanding of the entity's financial performance.

Drawing an analogy from the above, EAC was of the view that exceptional items could be items that are material and are infrequent in occurrence.

Further, the EAC noted that the requirements of Schedule III to the Companies Act, 2013 and Ind AS 1 require items to be presented and classified as per their nature and also require specific items such as 'finance costs' to be disclosed in a specific manner.

Considering the specific facts and circumstances of the Company, having a global presence in oil and gas sector and its past experience where incidence of force majeure events and related costs is not infrequent, EAC has opined that the stoppage and standby expenditure incurred during force majeure (although may meet the test of 'materiality'), should not be presented as exceptional items in profit and loss. However, since these are 'material', the Company should disclose their nature and amount separately and may also present these items by disaggregating, headings and subtotals under their respective heads in profit and loss when such presentation is relevant to an understanding of the entity's financial performance.

EAC opined that the nature of finance costs does not change due to suspension of construction activities because of force majeure and therefore, its nature cannot be considered as exceptional. Thus, the same should be presented as part of 'Finance costs' and not as an exceptional item in profit and loss.

D Other EACs:

EAC-12 Recognition of Leased Project Assets as Identified Assets as per Ind AS 116

Background

A Company is in business of borrowing funds for construction of assets which are then leased out to the Ministry of Railways (MoR). The Company has entered into a lease agreement with MoR, whereby the agreement explicitly provides the details of project assets, which are being leased to the MoR.

Briefly illustrated by the Company: If MoR decides to construct a railway track out of which MoR share is 20% and balance 80% is constructed by the Company. This 80% is then leased to MoR in its entirety. However, it cannot be physically identified as to which 20% is owned by MoR and which 80% is owned by the Company.

Assets listed in agreement have been identified by MoR and are constructed in accordance with the parameters as desired by MoR. Lease agreement states that Company is not in business of construction and in no way provides any warranty relating to project assets.

In the event of loss / damage of project assets, the same shall be borne by MoR along with regular maintenance and repair of the asset.

Company is subject to regular audit by C&AG. C&AG have observed that the project assets do not qualify to be Identified Asset. In Company's opinion, all conditions of Ind AS 116 for an asset to be identified asset are satisfied.

Issue under consideration

EAC opinion was sought whether the project asset is an identified asset, and a lease exists.

EAC view

As per Ind AS 116, contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. 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.

EAC has noted that lease agreement identifies the name and detail of the project assets that are the subject matter of the lease agreement. Further, based on various clauses of the agreement, lessor does not have the right of substitution. Therefore, the project assets specified in the lease agreement will be used to fulfill the contract. Hence, even though the asset may not be physically distinct, the asset is implicitly specified and is an identified asset.

Pursuant to lease agreement, lessee has taken project assets on lease for specified lease period in exchange for agreed periodic payments. Lease agreement provides lessee the right to use project assets in a normal way and perform maintenance and repairs at its own cost and volition. Company has leased its entire share of asset constructed by it to the MoR and the entire capacity of the asset is being used by the MoR either through ownership or lease from the Company. Thus, the lessee has exclusive right to use the project assets throughout the lease period.

Since the asset has been explicitly designed and built as per the requirements of the lessee and lessee also has the right to use and operate the identified asset, the lessee has the right to direct how and for what purpose the asset is used throughout the period of use.

Based on the above, EAC has opined that the lease agreement conveys the right to control the use of an identified asset for a period of time in exchange for consideration and therefore, is or contains a lease.

EAC-13 Accounting treatment of similar leasehold assets held by parent and subsidiary company with different functional currencies and consolidation thereof

Background

Child Ltd and Parent Ltd are in the business of oil and gas exploration and production outside India and in India, respectively. Child Ltd identifies the US dollar as its functional currency. However, it presents its financial statements in INR according to Schedule III of Companies Act, 2013. Child Ltd translates its financial statements from USD to INR in line with the provision of Ind AS 21.

Both Child Ltd and Parent Ltd acquired adjacent pieces of land on perpetual lease at the same consideration and capitalized as Right of Use (RoU-Land) asset valued at USD 46 Million and INR 200 crores respectively.

Child Ltd then subsequently revalued the asset to the presentation currency (INR) and accounted exchange differences which is reflected in the Foreign Currency Translation Reserve (FCTR) via Other Comprehensive Income (OCI). The RoU-Land was valued at INR 350 crores as on 31st March 2022.

However, C&AG raised a concern that this translation includes an appreciation of INR 150 crores in the cost of land which is a material amount and therefore, should have been disclosed appropriately considering the fact that an identical piece of adjacent land acquired by Parent Ltd is being shown at original value i.e., INR 200 crores.

Further, C&AG also pointed out that in the consolidated financial statements (CFS) of Parent Ltd, the correct picture is not presented as two same kinds of assets, acquired by group at the same time, at same original acquisition value are now being presented at different carrying value in INR and therefore in CFS, adjustment should be made to reflect the value of RoU-Land of Child Ltd at its original INR value.

Issue under consideration

EAC opinion was sought in regard to translation of leasehold land of Child Ltd for separate financial statements and whether any adjustments are required in value of leasehold land of Child Ltd for CFS of Parent Ltd.

EAC view

As per Ind AS 21, on initial recognition, an entity shall translate a foreign currency item into its functional currency using exchange rate at the date of the transaction.

Further, as per Ind AS 21, when the presentation currency is different from functional currency, the assets and liabilities for each balance sheet date are translated using the closing rate at the date of balance sheet, irrespective of whether such items are monetary or non-monetary. The resulting exchange differences is to be recognized in other comprehensive income.

Based on above, EAC has opined that RoU-Land, acquired by Child Ltd is denominated in INR and therefore, on initial recognition, translation of RoU-Land (foreign currency item in INR) into its functional currency i.e., USD using exchange rate at the date of the transaction is in accordance with Ind AS 21.

Since Child Ltd is presenting its financial statements in INR, translation of the RoU-Land from functional currency (USD) to presentation currency (INR) using the closing exchange rate at the balance sheet date is in accordance with Ind AS 21.

Further, the additions to RoU-Land should also include the net exchange differences arising from the translation of the financial statements from the functional currency into a different presentation currency.

EAC has further opined that, the RoU-Land of Child Ltd shall appear in the CFS of Parent Ltd after translating its value in functional currency (USD) into presentation currency of Parent Ltd (INR) using the exchange rates at the date of the balance sheet. It is noted that Ind AS 110 does not give any exception to this requirement and requires following normal consolidation procedures to combine like items of the parent with those of its subsidiaries. Therefore, the presentation of RoU-Land of Child Ltd at the revised translated amount using the exchange rate at the balance sheet date in the CFS of Parent Ltd is in accordance with Ind AS 110. However, appropriate disclosures, as per Ind AS 116, should also be made in the financial statements.

EAC has offered guidance and clarification on various issues encountered by companies in financial reporting. Emphasizing the need for substance over form, the committee urges companies to consider the nature of an arrangement when determining its classification, presentation, and disclosure in financial statements. The EAC further advises companies to carry out an exhaustive evaluation of all pertinent facts and circumstances to accurately reflect their implications in the financial statements.

Pradeep Suresh

Partner, Financial Accounting Advisory Services (FAAS), EY India

3. IFRS Interpretations Committee Discussion (IFRS IC)

IFRIC Tentative Agenda Decision Paper:

1. Disclosure of revenues and expenses for reportable segments [International Financial Reporting Standard (IFRS) 8, Operating Segments]

November 2023

Background

Para 23 of IFRS 8 requires an entity to disclose the specified amounts for each reportable segment when those amounts are included in the measure of segment profit or loss reviewed by the Chief Operating Decision Maker (CODM), even if they are not separately reviewed by the CODM, or when those amounts are regularly provided to the CODM, even if they are not included in the measure of segment profit or loss. The information to be reported are mentioned in sub para (a) to (i) of para 23 of IFRS 8 and includes information like revenue from external customers, interest revenue, material items of income and expense disclosed in accordance with IAS 1, etc.

Issue

IFRS Interpretation Committee (hereinafter referred as 'IFRS IC') had received a request to clarify following:

a) Whether an entity needs to disclose amounts in para 23 (a)-(i) of IFRS 8 for each reportable segment even if they are not separately reviewed by the CODM.

b) Whether information pertaining to material items of income and expense are to be disclosed for reportable segments if the entity presents or discloses that information applying requirement in other IFRS apart from IAS 1.

c) And, how an entity determines ‘material items’ in para 23(f) of IFRS 8, more particularly, whether they are material qualitatively, or it includes amounts that are aggregation of individually quantitatively immaterial items? Also, materiality assessment needs to be performed at the income statement level or segment level.

Discussion

With regards to the first part of the question, the IFRS IC points out that para 23 of IFRS 8 requires an entity to disclose the specified amounts for each reportable segment when those amounts are included in the measure of segment profit or loss reviewed by the CODM, even if they are not separately reviewed by the CODM, or when those amounts are regularly provided to the CODM, even if they are not included in the measure of segment profit or loss.

While addressing point b and c in the issue, the IFRIC IC references to para 7 of IAS 1 and para 30-31 of IAS 1 and accordingly stated that in applying para 23 (f) of IFRS 8, an entity:

(i) applies para 7 of IAS 1 and assesses whether the disclosure of information is material in the context of the financial statements taken as a whole,

(ii) apply the requirements in para 30-31 of IAS 1 in considering how to aggregate information in the financial statements.

(iii) consider both quantitative and qualitative factors, representing the nature or magnitude of information, or both, in assessing whether an item of income and expense is material and

(iv) considers an item for disclosure without regard to whether that item is presented or disclosed, applying a requirement other than para 97 of IAS 1.

Conclusion

The IFRS IC concluded that the principles and requirements in IFRS provide an adequate basis for an entity to apply the disclosure requirements in para 23 of IFRS 8.

How we see it

It is very important for the companies to review, along with their internal Management Reporting, other financial information which are regularly presented to CODM. If any of the information as provided in para 23 (a) to (i) are separately reviewed by CODM (even-though not being a part of internal Management Reporting), the same are required to be presented as per requirements of para 23 of IFRS 8.

2. Climate-related commitments [International Accounting Standard (IAS) 37 Provisions, Contingent Liabilities and Contingent Assets]

November 2023

Background

In 20X0, a manufacturer publicly state its commitment to reduce its greenhouse gas emissions by at least 60% by 20X9 and offset the remaining emissions in 20X9 and thereafter by buying carbon credits and retiring them in the carbon market.

With its statement, the entity publishes a detailed plan setting out how it will gradually modify its manufacturing methods between 20X1 and 20X9 to achieve the 60% reduction in emissions by 20X9. The modifications will involve investing in more energy-efficient processes, buying energy from renewable sources, etc.

Issue

a) Whether such a commitment to reduce or offset greenhouse gas emissions creates a constructive obligation

b) whether such constructive obligation meets criteria in IAS 37 for recognizing a provision

c) if a provision is recognized, whether the expenditure required to settle it, is recognized as an expense or as an asset.

Discussion

The IFRS IC observed that whether an entity’s statement of its commitment to reduce or offset its emissions creates a valid expectation that it will fulfill its commitment and hence creates a constructive obligation depends on the facts of the commitment and the circumstances surrounding it. Management would apply judgement to reach a conclusion considering those facts and circumstances.

With regards to part (b) of the issue, the IFRS IC referred to para 14 of IAS 37, which requires an entity to recognize a provision when the entity has,

(i) a present obligation as a result of past event

(ii) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and

(iii) a reliable estimate can be made of the amount of the provision.

The IFRS IC, referring to illustrative example 2B accompanying IAS 37 and para 18 and para 19 of IAS 37, concluded that if the fact pattern creates a constructive obligation for the entity as mentioned above, that obligation is not a present obligation as a result of past event when the entity publicly states its commitment in 20X0, as the entity has not taken the actions to which the statement applies. IFRS IC also stated that the entity will never have a present obligation for future modifications to its manufacturing methods because these costs will always be incurred in future and the entity, at some point will have to pay for the resources it purchases to modify its methods, but only when it receives these resources. Only when the entity has emitted the greenhouse gases that it has committed to offset will it have a present obligation to retire the carbon credits required to offset those greenhouse gases. The entity will have a present obligation to retire carbon credits only if and when it emits greenhouse gases in 20X9 and later years.

The second criterion for recognizing a provision is that it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, to which the committee stated that although the entity will incur expenditure to modify its manufacturing methods, it will receive other resources - for example PPE, packing material etc in exchange of that expenditure and it will be able to use these resource to manufacture products it can sell at a profit and accordingly, it will not require an outflow of resources embodying economic benefits. However, settling the obligation to offset the entity's remaining greenhouse gas emissions will require an outflow of resources. The entity will be required to retire carbon credits without receiving any resources in exchange.

Regarding the third criterion, IFRS IC believed that it is likely that the entity would be able to make a reliable estimate of the amount of a constructive obligation that satisfy the other recognition criteria.

Hence, the IFRS IC concluded that:

a) whether the entity's statement of its commitment to reduce and offset its greenhouse gas emissions creates a constructive obligation depends on the facts of the statements and circumstances surrounding it.

b) If the statement creates a constructive obligation, the entity does not recognize a provision when it makes that statement. At that time, the constructive obligation is not a present obligation as a result of a past event. However, as the entity emits greenhouse gases in 20X9 and thereafter, it will incur a present obligation to retire the carbon credits to offset its past emissions and hence if the entity has not already retired the carbon credits required to offset its past emissions, it should recognize a provision if a reliable cost estimate can be made.

c) Regarding part (c) of the issue, IFRS IC observed that the expenditure is recognized as an expense, unless it qualifies for recognition as an asset that qualifies for recognition under other IFRS.

IFRS IC observed that, irrespective of whether an entity's commitment to reduce or offset its greenhouse gas emissions results in the recognition of a provision, the actions the entity plans to take to fulfill that commitment could affect the amounts at which it measures its other assets and liabilities and the information it discloses about them, as required by various IFRS.

Conclusion

IFRS IC concluded that the principles and requirements in IFRS provide an adequate basis for an entity to determine the issues, as mentioned.

How we see it

This is a very relevant issue in the current economic environment in various jurisdictions. It is very important for companies to look at their public statements, commitments on emission and related communication to determine whether it meets the definition of constructive obligation as defined in IAS 37. It is also necessary to analyze, whether owing to that constructive obligation, whether there is an outflow of resources embodying economic benefits and hence, whether there is a need for the provision.

Company to apply judgements based on relevant jurisdiction, facts and circumstances to determine whether the commitments to reduce or offset greenhouse gas emissions meets the definition of constructive obligation and if so, whether it further meets criteria of recognition of provision.

Darshan Varma

Partner, Financial Accounting Advisory Services (FAAS), EY India

4. Presentation and Disclosures – Key considerations

Introduction

Presentation and disclosure in financial statements are crucial for providing transparency to stakeholders. It helps users to understand the financial health and performance of a company. Regulators are putting more emphasis on presentation and disclosures in financial statements due to changing business landscapes, evolving stakeholders' expectations, ongoing efforts to enhance global harmonization and prevent financial misconduct.

Some of the key presentation and disclosures considerations are as follows:

Section A:
Financial Reporting Review Board - key presentation and disclosures considerations

Financial Reporting Review Board ('FRRB') of Institute of Chartered Accountants of India ('ICAI') works toward improving and strengthening of financial reporting practices in the country. FRRB reviews the general-purpose financial statements of enterprises and auditor's report thereon selected on Suo motto basis or on reference by regulatory bodies. Such a review conducted by FRRB is neither a judicial proceeding nor the quasi-judicial proceeding.

Following are certain key observations in respect of non-compliance of Ind AS and Schedule III to the Companies Act, 2013 disclosures published by FRRB in its article during September and November 2023.

Observations on asset related disclosures:

1. Treatment of internally generated goodwill and impairment testing

As per Ind AS 38, "Internally generated goodwill shall not be recognized as an asset".

As per Ind AS 36, "An entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset." Further, as per Ind AS 36, "Irrespective of whether there is any indication of impairment, an entity shall also test goodwill acquired in a business combination for impairment annually."

FRRB noted that the company holds substantial goodwill within its total assets and shown as a part of Property, Plant and Equipment. However, there are deficiencies in the disclosure policies:

a) Absence of clarification regarding goodwill recognition on account of business combinations.

b) Lack of disclosure related to goodwill impairment within the financial statements.

c) The company should adhere to Division II - Ind AS Schedule III to the Companies Act ,2013 by presenting Goodwill as a distinct line item on the balance sheet, separate from 'Other Intangible Assets'. Therefore, including 'Goodwill' within the note on Property, Plant, and Equipment is an incorrect disclosure.

2. Derecognition of investments in equity instruments

As per Ind AS 107, "If an entity derecognized investments in equity instruments measured at fair value through other comprehensive income during the reporting period, it shall disclose:

a) the reasons for disposing of the investments.

b) the fair value of the investments at the date of de-recognition.

c) the cumulative gain or loss on disposal."

FRRB noted that equity investments designated at fair value through other comprehensive income ('FVOCI') were derecognized within the year. However, the company did not disclose the reasons for derecognition, fair value of the investments at the derecognition date, or the cumulative gains and losses on disposal, as required by Ind AS 107 across the financial statements.

3. Non-current asset held for sale or sold in the financial statements

As per Ind AS 105, an entity shall disclose the following information in the notes in the period in which a non-current asset (or disposal group) has been either classified as held for sale or sold:

a) a description of the non-current asset (or disposal group).

b) a description of the facts and circumstances of the sale, or leading to the expected disposal, and the expected manner and timing of that disposal.

c) the gain or loss recognized in accordance with para 20-22 (i.e., impairment losses and reversal) and, if not separately presented in the statement of profit and loss, the caption in the statement of profit and loss that includes that gain or loss.

d) if applicable, the reportable segment in which the non-current asset (or disposal group) is presented in accordance with Ind AS 108, 'Operating Segments'.

FRRB noted that land and building have been classified as 'assets held for sale' and its profit has been disclosed under note on other income. However, the Board noted that the company has not made the disclosures as required above under Ind AS 105 anywhere in the financial statements.

Observations on equity related disclosures

1. Prescribed equity presentation: Division II-Ind AS Schedule III to the Companies Act, 2013

Format of Balance Sheet as prescribed under Division II - Ind AS Schedule III to the Companies Act, 2013 requires only two items to be disclosed as part of equity which are 'equity share capital' and 'other equity'. Retained earnings are disclosed as part of the 'Statement of Changes in Equity.'

FRRB noted that the company has disclosed equity on the face of the balance sheet as follows:

a) Equity share capital

b) Retained earnings

c) Other equity

It was noted that there is no requirement to disclose 'Retained Earnings' on the face of the Balance Sheet. Accordingly, it was viewed that the company's disclosure of Equity is not in line with the requirements of Schedule III to the Companies Act, 2013.

2. Nature and purpose of reserves within other equity

As per Para 79 of Ind AS 1, "An entity shall disclose the following, either in the balance sheet or the statement of changes in equity, or in the notes: ....(b) a description of the nature and purpose of each reserve within equity."

Guidance note on Division II-Ind AS Schedule III to the Companies Act, 2013 requires following disclosure under Reserves & Surplus:

....

"(c) Other Reserves (specify the nature and purpose of reserve and the amount in respect thereof):

Every other reserve which is not covered in above para is to be reflected as 'Other Reserves.' However, since the nature, purpose and the amount are to be shown, each reserve under 'Other Reserves' is to be shown separately in Notes to Accounts."

In the notes to the financial statements on other equity, FRRB noted that the nature and purpose of the reserves with the company were not disclosed. Hence, the existing disclosure was not in line with the requirements of Ind AS 1 and Schedule III to the Companies Act, 2013.

Observations on liabilities related disclosures

1. Term loan classification under Division II - Ind AS Schedule III to the Companies Act, 2013

Guidance Note on Division II – Ind AS Schedule III to the Companies Act, 2013 requires 'Term Loan' to be shown under Non-Current Borrowings, however term loan has not been defined in division II - Ind AS Schedule III to the Companies Act, 2013.

FRRB noted that loans repayable on demand have also been disclosed as Term Loan. Since the basic characteristics of a term loan is that it has a fixed or predetermined maturity period or a repayment schedule, loan repayable on demand cannot be said to have a fixed or pre-determined maturity period. Therefore, the loan repayable on demand shall not be classified as 'Term Loan.' The same should have been disclosed as 'Loans repayable on demand' in accordance with para 6 F I (i) (a) of the General Instructions for the preparation of Balance Sheet under Division II - Ind AS Schedule III to the Companies Act, 2013.

Accordingly, the company's current practice of presenting loan repayable on demand under the label of 'Term Loan' is not in line with the requirements of division II - Ind AS Schedule III to the Companies Act, 2013.

2. Disclosure requirements for Micro, Small, and Medium Enterprises (MSMEs) under Division II - Ind AS Schedule III to the Companies Act, 2013

Para 6 (FA) of General Instructions for preparation of Balance Sheet given under Part – I of Division II - Ind AS Schedule III to the Companies Act, 2013, introduced by MCA via Notification No. GSR 679 (E) dated 4 September 2015 requires following details relating to Micro, Small and Medium Enterprises to be disclosed in the notes: -

a) the principal amount and the interest due thereon (to be shown separately) remaining unpaid to any supplier at the end of each accounting year.

b) the amount of interest paid by the buyer in terms of section 16 of the MSME Development Act, 2006, along with the amount of the payment made to the supplier beyond the appointed day during each accounting year.

c) the amount of interest due and payable for the period of delay in making payment (which has been paid but beyond the appointed day during the year) but without adding the interest specified under the said act.

d) the amount of interest accrued and remaining unpaid at the end of each accounting year.

e) the amount of further interest remaining due and payable even in the succeeding years, until such date when the interest dues above are actually paid to the small enterprise, for the purpose of disallowance of a deductible expenditure under section 23 of the said act.

FRRB noted that:

(i) In the note on 'Trade Payables,' trade payables were disclosed by way of two-line items viz. 'trade payables for goods and services' and 'trade payables for salaries and wages, which is not required by division II - Ind AS Schedule III to the Companies Act, 2013.

(ii) It was further noted that neither on the face of the balance sheet nor in the notes to the accounts the trade payables were segregated into two parts viz. 'total outstanding dues to micro enterprises and small enterprises' and 'others.'

(iii) The details required under para 6 (FA) of General Instructions for preparation of Balance Sheet, Part I of Division II - Ind AS Schedule III to the Companies Act, 2013 were not disclosed by the company.

Accordingly, it was viewed that the existing presentation of trade payables is not in line with the requirements of Schedule III to the Companies Act, 2013.

3. Discounting provisions as per Ind AS 37

Para 46 of Ind AS 37 requires: "Because of the time value of money, provisions relating to cash outflows that arise soon after the reporting period are more onerous than those where cash outflows of the same amount arise later. Provisions are therefore discounted, where the effect is material."

FRRB noted that the company has stated in its accounting policy that provisions (excluding retirement benefits) were not discounted to their present value. However, as per Ind AS 37, when the effect of time value of money is material, the carrying amount of the provision is the present value of those cash flows.

Accordingly, an outright statement that no provision is discounted without giving accord to the time value of money and materiality of its effect is not correct and not in line with Ind AS 37.

Observations on profit and loss related disclosures

1. Interest income

As per Ind AS 109, 'Interest revenue' shall be calculated by using the effective interest rate (EIR) method. This shall be calculated by applying the EIR to the gross carrying amount of a financial asset except for:

a) Purchased or originated credit-impaired financial assets. For those financial assets, the entity shall apply the credit adjusted EIR to the amortized cost of the financial asset from initial recognition.

b) Financial assets that are not purchased or originated credit impaired financial assets but subsequently have become credit-impaired financial assets. For those financial assets, the entity shall apply the EIR to the amortized cost of the financial asset in subsequent reporting periods."

FRRB noted that the Company has recognized the Interest income on accrual basis and not by using EIR method. Accordingly, it was viewed that the requirements of Ind AS 109 have not been complied with in preparation and presentation of the financial statements.

2. Government grant

As per Ind AS 20, "Government grants are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the entity."

Para 39 (a) requires disclosure of the accounting policy adopted for government grants, including the methods of presentation adopted in the financial statements.

Further, as per ITFG Issue 105, exemption of custom duty is a government grant and should be accounted for as per the provisions of Ind AS 20.

FRRB noted that the exemption of custom duty under the Software Technology Parks of India scheme is a government grant and should be accounted for as per the provisions of Ind AS 20. However, the company has not disclosed the policy on accounting for Government Grant as required by para 39 (a) of Ind AS 20. Accordingly, it was viewed that the requirements of Ind AS 20 have not been complied with.

3. Corporate social responsibility (CSR) expenses

The Guidance Note on Division II – Ind AS Schedule III to the Companies Act, 2013, requires the following disclosure in the notes to accounts related to CSR expenditure:

a) Gross amount required to be spent by the company during the year.

b) Amount spent during the year on:

(i) Construction/acquisition of any asset,

(ii) On purposes other than (i) above.

The above disclosure, to the extent relevant, may also be made in the notes to the cash flow statement, where applicable.

FRRB noted that the company has not disclosed the gross amount required to be spent during the year, amount spent on construction and otherwise in line with Guidance Note on Division II – Ind AS Schedule III to the Companies Act, 2013. Accordingly, it was viewed that the 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.

4. Income tax

As per Ind AS 12, "A deferred tax asset shall be recognized for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilized, unless the deferred tax asset arises from the initial recognition of an asset or liability in a transaction that:

a) Is not a business combination; and

b) At the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).

However, for deductible temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, a deferred tax asset shall be recognized in accordance with para 44."

FRRB noted that the company has stated in its accounting policy on income taxes that the deferred tax assets have been recognized and carried forward only to the extent of reasonable or virtual certainty, as the case may be, that the assets will be realized in the future.

FRRB viewed that the use of the word 'reasonable and virtual certainty' has been derived from AS 22 on 'Accounting for taxes on Income' under Indian GAAP. However, financial statements are prepared by the company under Ind AS framework and para 24 of Ind AS 12 uses the term 'probable' and not the terms 'reasonable or virtual certainty'. Accordingly, it was viewed that the adopted policy on Income Taxes is not in line with the Ind AS 12.

5. Earnings per share

As per Ind AS 33, "If the number of ordinary or potential ordinary shares outstanding increases as a result of a capitalization, bonus issue or share split, or decreases as a result of a reverse share split, the calculation of basic and diluted earnings per share for all periods presented shall be adjusted retrospectively.

FRRB noted that the bonus shares were issued by the company during the year and the same has, although, been considered for calculation of basic and diluted earnings per share for current financial year, however, these bonus shares were not considered for calculation of basic and diluted earnings per share of the previous year. Accordingly, it was viewed that requirements of para 64 of Ind AS 33 have not been complied with in preparation and presentation of the financial statements.

Section B: Research Committee of ICAI- Insights on presentation and disclosure requirements

A. Key presentation and disclosure related case studies covered by ICAI in its publication on excellency in financial reporting July 2023

The Research Committee of ICAI has released a publication that incorporates fictional case studies for a better clarity of the implementation of Ind AS. These case studies provided within offer collection of in-depth analysis of practices adopted in implementation of Ind AS and common errors made thereby. By delving into these case studies, readers will gain valuable knowledge and inspiration to improve their own financial reporting practices.

We have compiled a summary of select case studies pertaining to the presentation and disclosure requirements.

1. Are the sitting fees paid to an independent director and a non-executive director also required to be disclosed under Related Party Disclosure under Ind AS 24?

As per definition given in Para 9 of Ind AS 24, Related Party Disclosures, "Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity." Accordingly, Independent directors and non-executive directors are also key management personnel, as they have the authority and responsibility for planning, directing, and controlling the activities of the entity.

Para 17 of Ind AS 24 requires that "An entity shall disclose key management personnel compensation in total and for each of the following categories: (a) short-term employee benefits; (b) post-employment benefits; (c) other long-term benefits; (d) termination benefits; and (e) share-based payment."

As per Para 9 of Ind AS 19, Employee Benefits, "Short-term employee benefits include items such as the following, if expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related services: (a) wages, salaries and social security contributions; (b) paid annual leave and paid sick leave; (c) profit-sharing and bonuses; and (d) non-monetary benefits (such as medical care, housing, cars and free or subsidized goods or services) for current employees."

As per ITFG Bulletin 11 Issue 9 – The sitting fees paid to directors will fall under the definition of 'Short-term employee benefits' as per Ind AS 19 and is required to be disclosed in accordance with the para 17 of Ind AS 24.

Based on the above guidance, the Committee of ICAI noted that the entity shall disclose the sitting fees paid to independent director and non-executive director under short-term employee benefits on same lines as shown for Executive Directors.

2. In case goods are lost in transit due to accident are covered by insurance policy. According to the surveyor report, the claim amount is collectible subject to the deductible clause i.e., 15% of claim, is that claim to be recognized in financial statements or to be disclosed as contingent assets in case the entity received informal information from the insurance company that their claim had been processed and the payment had been dispatched for 85% of the claim amount

When the goods lost in an accident are covered by the insurance policy, compensation is receivable from the insurance company. Such claim qualifies the definition of a contingent asset as given below:

As per Para 10 of Ind AS 37, "A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity."

Further, as per Para 31 read with Para 33 of Ind AS 37, "An entity shall not recognize a contingent asset since this may result in the recognition of income that may never be realized. However, when the realization of income is virtually certain, then the related asset is not a contingent asset, and its recognition is appropriate." As per Para 34 of Ind AS 37, "A contingent asset is disclosed, as required by para 89, where an inflow of economic benefits is probable."

As per Para 35 of Ind AS 37, "Contingent assets are assessed continually to ensure that developments are appropriately reflected in the financial statements. If it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognized in the financial statements of the period in which the change occurs. If an inflow of economic benefits has become probable, an entity discloses the contingent asset."

Based on the above guidance, the virtual certainty of receipt will be there when informed through formal communication that the amount will be received. Accordingly, Research Committee of ICAI noted that the entity would need to disclose the contingent asset to the extent of 85% on the reporting date considering that the entity has received informal information from the insurance company. However, it is important that disclosures for contingent assets avoid giving misleading indications of the likelihood of income arising as per para 90 of Ind AS 37.

3. What is the correct presentation for borrowings by an entity when it has to be settled by delivering machinery?

Para 11 of Ind AS 32 defines the term financial liability. The relevant extract is as follows:

"A financial liability is any liability that is a contractual obligation:

(i) to deliver cash or another financial asset to another entity

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the entity"

Ind AS 32 classifies liability as financial liability if the entity has a contractual obligation to deliver financial asset or exchange financial asset under condition that are unfavorable to the entity.

In the given case, since machinery is not a financial asset, the stated borrowing arrangement does not meet any of the criteria of financial liability. Hence, the borrowing will be classified as non-financial liability.

Accordingly, the Research Committee of ICAI noted that the borrowings will be shown under other non-current liabilities and in the notes to accounts the terms of agreement will be disclosed (including settlement terms).

B. Commonly found errors in reporting practices

The Research Committee of the Institute of Chartered Accountants of India (ICAI) has compiled the observations encountered during the evaluation process of ICAI Awards for Excellence in Financial Reporting 2022-23 in the form of publication 'Commonly Found Errors in Reporting Practices' released in January 2024. Some of the critical observations that can assist in enhancing the quality of reporting processes have been presented below:

1. Impact of amendments in accounting standards

On 31 March 2023, MCA issued the Companies (Indian Accounting Standards) Amendment Rules, 2023, which have amended certain existing standards. Company has disclosed this under the heading 'Recent Pronouncements' and has mentioned that "The company is evaluating the impact of above amendments in its financial statements".

The Committee recommended that the company should analyze the impact of such pronouncements till the approval of financial statements and should describe the impact thereof in the annual report. Further, if the company concludes that there is no significant impact of such amendments on its financial statements, then the company should specifically disclose it.

Illustrative disclosure is as follows: "Based on preliminary assessment, the Company does not expect these amendments to have any significant impact on its standalone financial statements."

2. Basis of ageing schedule for Trade Receivables and Trade Payables

As per Division II - Ind AS Schedule III of Companies Act, 2013, trade receivables and trade payables ageing schedule is to be presented on the basis of due date of payment and where due date of payment is not specified, disclosure shall be from date of the transaction.

The Committee observed that the company has disclosed the trade receivables and trade payables ageing schedule from the date of transaction. It indicates that the due date of payment is not specified in any of the invoices, which do not seem to be realistic.

The Committee recommended that the company should present the ageing schedule in two parts i.e., where due date of payment is specified, ageing on the basis of due date of payment and where due date of payment is not specified, ageing on the basis of date of transaction to comply with the provisions of Companies Act, 2013.

3. Details of title deeds of immovable property not held in the name of the Company

As per amendment made in Schedule III, "The company shall provide the details of all the immovable property (other than properties where the Company is the lessee and the lease agreements are duly executed in favor of the lessee) whose title deeds are not held in the name of the company in format prescribed in the law and where such immovable property is jointly held with others, details are required to be given to the extent of the company's share."

The Committee observed that the company has not provided all the details for the Immovable property whose title deed is not in the name of the company as per amendment made in Division II - Ind AS Schedule III of the Companies Act, 2013 in the required format. Further, it was observed that the company has not disclosed the reason for the same, rather it has disclosed the status as on reporting date for the same as 'lease deed execution is under process'.

The Committee recommended that the tabular format as prescribed should be followed for proper reporting. Further, the company should provide the exact reason instead of disclosing the present situation in relation to the title deeds of these properties.

4. Debentures: Terms of redemption / conversion

As per Division II - Ind AS Schedule III to the Companies Act, 2013, the 'General Instructions to the preparation of Balance Sheet' requires presentation of borrowings as follows:

Bonds/debentures (along with the rate of interest and particulars of redemption or conversion, as the case may be) shall be stated in descending order of maturity or conversion, starting from farthest redemption or conversion date, as the case may be. In cases where bonds/debentures are redeemable by instalments, the date of maturity for this purpose must be reckoned as the date on which the first instalment becomes due.

The Committee observed in a few cases that the disclosures are incomplete - either terms of redemption / conversion or the dates of redemption / conversion were not disclosed in descending order. The Committee has suggested the following illustrative format for presenting the maturity profile of bonds/ debentures:

Rate of Interest	Non-current			Current
	2025-26	2024-25	Total	2023-24
8.00%				
8.25%				
9.50%				
Total				

5. Share application money received pending allotment / calls received in advance

As per Division II - Ind AS Schedule III to the Companies Act, 2013, the 'General Instructions to the preparation of Balance Sheet' require that the share application money pending allotment to the extent not refundable shall be shown under the head Equity and share application money to the extent refundable shall be separately shown under 'Other financial liabilities'.

The Committee observed that share application money received pending allotment was included in equity capital disclosed on the face of the balance sheet. The note on share capital disclosed the share application money separately as being added to the share capital. Hence, such a presentation is not in compliance with the requirements of Division II - Ind AS Schedule III to the Companies Act, 2013.

6. Investment property

As per Ind AS 40, "An entity shall adopt as its accounting policy the cost model prescribed in para 56 to all of its investment property. Further, as per para 32, all entities are required to measure the fair value of investment property for the purpose of disclosure, even though they are required to follow the cost model for measurement purpose."The Committee observed in certain cases where the company had investment property. The accounting policy mentioned that the investment property was stated at a fair value instead of cost. Hence, such an accounting policy is not in line with Ind AS 40.

Section C:

Other critical frequently asked questions and how we see it

While preparing financial statements under Ind AS framework, the entity may come across many questions with respect to interpretation of standard, performing complex calculations and ensuring completeness, etc. While questions can be many, below are certain pertinent questions by various companies while preparing such financial statements.

1. Are sustainability disclosure reporting standards applicable to the companies reporting in Ind AS framework for FY2023-24?

In November 2021, the IFRS Foundation has set up the international sustainability standard board (ISSB), a new standard setting board to issue standards on sustainability. In June 2023, the ISSB issued its first sustainability disclosure standards, IFRS S1 and S2 (effective from 1 January 2024). However, there has been no corresponding financial reporting standard issued in India.

Further, Ind AS 1 para 14 clarifies that reports and statements, such as environmental reports and value-added statements presented by many entities outside the financial statements, are beyond the scope of Indian Accounting Standards. Hence, the applicability of sustainability standards in India in general purpose financial reporting is not known at present.

In India, SEBI has made reporting on Environmental, Social, and Governance (ESG) parameters mandatory for top 1000 listed entities by market capitalization from FY 2022-23 through Business Responsibility and Sustainability Report (BRSR) as part of the annual report.

ICAI has made the following observation on BRSR reporting:

- Entities have failed to disclose the entity's approach towards sustainability reporting.
- Sustainability reporting lacked integration with integrated reporting.
- Information was presented in a subjective manner rather than an objective one and in certain reports, data from corresponding previous year was not included in the sustainability reporting.

Hence, ICAI recommends that, as a best reporting practice and in line with the global benchmark, the entity should provide the disclosures in line with the requirements of IFRS S1 and S2 for qualitative sustainability reporting.

IFRS S1 sets out the requirements for disclosing information about an entity's sustainability-related risks and opportunities. In particular, an entity is required to provide disclosures about:

1. The governance processes, controls and procedures the entity uses to monitor, manage and oversee sustainability-related risks and opportunities
2. The entity's strategy for managing sustainability-related risks and opportunities
3. The processes the entity uses to identify, assess, prioritize and monitor sustainability-related risks and opportunities
4. The entity's performance in relation to sustainability-related risks and opportunities, including progress towards any targets the entity has set or is required to meet by law or regulation

Further, IFRS S2 sets out the requirements for disclosing information about an entity's climate-related risks and opportunities.

2. If financial liabilities that are not at fair value through profit and loss are used to finance a portfolio of trading financial assets (for example, trading debt securities), can the interest expense (funding costs) on such liabilities be included in net gains or net losses on financial assets or financial liabilities at fair value through profit or loss (FVTPL)?

Para 20 of Ind AS 107 Financial Instruments: Disclosures require separate disclosure of:

(1) Net gains or net losses on financial assets or financial liabilities at fair value through profit or loss (both designated and held for trading), and

(2) Total interest income and total interest expense (calculated using EIR) for financial assets or financial liabilities not at FVTPL.

Para BA.8 of Ind AS 109 Financial Instruments provides guidance on the kind of circumstances in which financial liabilities are held for trading. It specifically indicates that: "The fact that a liability is used to fund trading activities does not in itself make that liability one that is held for trading." It follows, therefore, that, where the funding liabilities are not at FVTPL, the related interest expense should be included in the interest expense line and not in net gains or net losses on financial assets or financial liabilities at fair value through profit or loss.

Based on the above guidance, financial liabilities are classified separately from financial assets, even where the former are funding the latter. The interest expense incurred on such liabilities, although such liabilities may be used to fund an entity's trading portfolio, is not considered to arise directly from the entity's trading activities and should be included in interest expense.

3. Is an entity required to disclose a write-down of any inventory at the end of an annual reporting period or any write-down during the annual reporting period?

Para 36 (e) of Ind AS 2 Inventories requires the disclosure of the amount of any write-down of inventories recognized as an expense in the period in accordance with para 34 of Ind AS 2.

Para 34 of Ind AS 2 related to recognition of expense, it requires "...the amount of any write-down of inventories to net realizable value and all losses of inventories shall be recognized as an expense in the period the write-down or loss occurs..."

Taken literally, this guidance means that any write-down, including any sales below cost during the reporting period, would be scoped into this disclosure para. However, the notion of 'write-down' is used in the context of the lower of cost and net realizable value test. An entity only performs this test at a reporting date. Therefore, an entity is required to disclose only write-downs of inventory held at the end of the reporting period.

4. Should the cash flows associated with the purchase of an asset on deferred terms be classified under investing activities or within financing activities?

Para 44 of Ind AS 7 states:

"Many investing and financing activities do not have a direct impact on current cash flows, although they do affect the capital and asset structure of an entity. The exclusion of non-cash transactions from the cash flow statement is consistent with the objective of a cash flow statement, as these items do not involve cash flows in the current period. An example of non-cash transactions is the acquisition of assets either by assuming directly related liabilities or by means of a finance lease; ....."

Para 17 of Ind AS 7 provides examples of cashflows arising from financing activities, including cash payments by a lessee for the reduction of the outstanding liability relating to a finance lease. Thus, it classifies finance lease payments as a financing activity.

The length of the period between the acquisition of an asset and the following payment should determine the classification of the cash flows. Where an entity acquires an asset under a finance lease, and hence the length of the period between the acquisition of the asset and the following payment is significant, the acquisition of the asset is a non-cash transaction, and the payments to reduce the outstanding liability relating to a finance lease are financing cash flows.

On the other hand, where the length of the period between the acquisition of the asset and the following payment is not significant and payment does not give rise to imputed interest, the payment of the short-term payable for the purchase of an asset is an investing cash flow because short-term differences between the timing of an acquisition and payment should not change the nature of a capital expenditure to financing. This treatment appears to be implicit in Ind AS 7 Cash Flow Statements.

5. Is an entity required to provide all disclosures required under Ind AS even when that information is commercially sensitive or that disclosure would be seriously prejudicial to that entity's either in their segment note or within other parts of their financial statements, which might give new insights to competitors, suppliers, customers, and employees that could harm the entity's competitive position?

Ind AS does not permit exclusion of required disclosures based on potential competitive harm. The objective of Ind AS 1 Presentation of Financial Statements is to establish principles for reporting financial information to help users of financial statements better understand the entity's past performance, better assess the entity's risks, and returns, and make informed judgments about the entity.

Para 20 of Ind AS 108 Operating Segments provides the following core principle for segment reporting:

"An entity shall disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates."

Para 34 of Ind AS 108 Operating Segments provides that "an entity shall provide information about the extent of its reliance on its major customers. If revenues from transactions with a single external customer amount to 10% or more of an entity's revenues, the entity shall disclose that fact, the total amount of revenues from each such customer, and the identity of the segment or segments reporting the revenues. The entity need not disclose the identity of a major customer or the amount of revenues that each segment reports from that customer."

But Para 92 of Ind AS 37 Provisions, Contingent Liabilities and Contingent Assets provides a specific exception "In extremely rare cases, disclosure of some or all of the information required by para 84-89 can be expected to prejudice seriously the position of the entity in a dispute with other parties on the subject matter of the provision, contingent liability, or contingent asset. In such cases, an entity need not disclose the information, but shall disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed." The fact that a specific exception is made in Ind AS 37 supports the conclusion that disclosure is required unless an exception is provided explicitly.

Basis above guidance an entity is required to provide all disclosures required under Ind AS, even when the entity believes that the information is commercially sensitive or potentially detrimental to the entity, unless there is an explicit exemption or exception given in any Ind AS or any law.

6. If a court case initiated by the entity is unsettled at the end of the reporting period, and is subsequently settled favorably before the financial statements are authorized for issue, does the entity recognize an asset for the claim at the end of the reporting period?

Para 31 of Ind AS 37 Provisions, Contingent Liabilities and Contingent Assets states: "An entity shall not recognize a contingent asset since this may result in the recognition of income that may never be realized. However, when the realization of income is virtually certain, then the related asset is not a contingent asset, and its recognition is appropriate."

Para 34 of Ind AS 37 states: "a contingent asset is disclosed, as required by para 89, where an inflow of economic benefits is probable.

Para 35 of Ind AS 37 further clarifies: "If it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognized in the financial statements of the period in which the change occurs."

However, para 9 (a) of Ind AS 10 Events after the Reporting Period states: "the settlement after the reporting period of a court case that confirms that the entity had a present obligation at the reporting period" is an example of an adjusting event, and there is no indication that this refers to anything but liabilities. An entity only recognizes an asset if, at the end of the reporting period, the entity can show that it is virtually certain to win the case.

In this case, the change occurs after the reporting period. The settlement is not recognized as an asset in the statement of financial position at the end of the reporting period. However, if material, the entity discloses the subsequent settlement in the financial statements by way of a note.

These are very common non-compliances observed. Entities need to be vigilant and avoid these non-compliances to strengthen their financial reporting practices. Appropriate financial statement presentation and disclosure is critical as it boosts the shareholder's confidence while relying on the financial statements.

Jigar Parikh

Partner, Financial Accounting Advisory Services (FAAS), EY India

5. Clarification issued by National Financial Reporting Authority (NFRA)

As per sub-section 2 (b) of section 132 of the Companies Act 2013 read with rule 4 (2) (c) of the National Financial Reporting Authority Rules 2018 (NFRA Rules 2018), the National Financial Reporting Authority (NFRA) is mandated to monitor and enforce compliance with accounting standards and auditing standards.

During its recent review, NFRA has noted instances of non-compliance of Indian Accounting Standards with respect to disclosure of accounting policies for revenue from contract with customers and trade receivables. Observations on accounting policies are detailed as below:

i) Revenue from contracts with customers: recognition and measurement

As per para 46 of Ind AS 115, Revenue from Contracts with Customers, the entity shall recognize as revenue the amount of the transaction price, excluding the estimates of variable consideration that is allocated to that performance obligation. Appendix A to Ind AS 115 defines the 'transaction price' as the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties.

NFRA's observation on incorrect drafting of accounting policy

Considering the technical guidance mentioned in para above, NFRA noted that accounting policy drafted by several entities for recognition and measurement of revenue from contract with customers are not in compliance with the requirement of Ind AS 115. NFRA has stated one example of such erroneous accounting policy of a large-listed company, stated as below:

"Revenue is measured at the fair value of consideration received or receivable, taking into account the amount of discounts, incentives, volume rebates, and outgoing taxes on sales."

NFRA noted that the transaction price defined in appendix A to Ind AS 115 is different from 'fair value' defined in Ind AS 113 and Ind AS 32. Therefore, NFRA has advised all the listed companies and other entities falling with the domain of NFRA (which are required to follow Ind AS) to comply with the provisions of Ind AS 115 and disclose the appropriate accounting policy.

Suggested drafting of accounting policy by NFRA

NFRA noted that there are several companies which are disclosing the revenue recognition accounting policy in compliance with the requirement of Ind AS 115. NFRA has stated one such example of appropriate accounting policy, stated as below:

"Revenue towards satisfaction of a performance obligation is measured at the amount of transaction price (net of variable consideration) allocated to that performance obligation. The transaction price of goods sold, and services rendered is net of variable consideration on account of various discounts and schemes offered by the Company as part of the contract."

ii) Revenue from contracts with customers and trade receivables: recognition and measurement

As per para 5.1.1 of Ind AS 109, all financial assets are required to be initially measured at fair value plus transaction costs. Further, as an exception to these principles, according to para 5.1.3 read with para 5.1.1 of Ind AS 109, financial assets in the form of trade receivables, shall be initially measured at their transaction price (as defined in Ind AS 115) unless those contain a significant financing component determined in accordance with Ind AS 115 (or when the entity applies the practical expedient in accordance with para 63 of Ind AS 115).

NFRA's observation on incorrect drafting of accounting policy

Considering the technical guidance mentioned in para above, NFRA noted that several companies have disclosed in their accounting policy or separately that trade receivables are initially measured at fair value. The policy is not in compliance with the requirement of Ind AS 109. NFRA has stated one example of such erroneous accounting policy of a large-listed company, stated as below:

"Trade receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method less provision/ or impairment."

Further, NFRA noted that there have been instances of inconsistency between the accounting policy for initial measurement of trade receivables and the accounting policy for measurement of corresponding revenue. Therefore, NFRA has advised all the listed companies and other entities falling with the domain of NFRA (which are required to follow Ind AS) to comply with the provisions of Ind AS 109 and Ind AS 115 and disclose the appropriate accounting policy.

Suggested drafting of accounting policy by NFRA

NFRA noted that there are several companies which are appropriately reflecting the requirement of Ind AS 109 and Ind AS 115 while disclosing accounting policy. NFRA has stated one such example of appropriate accounting policy, stated as below:

Financial assets: initial recognition and measurement - All financial assets are recognized initially at fair value, plus in the case of financial assets not recorded at fair value through profit or loss (FVTPL), transaction costs that are attributable to the acquisition of the financial asset. However, trade receivables that do not contain a significant financing components are measured at transaction price.

Revenue recognition - Revenue towards satisfaction of a performance obligation is measured at the amount of transaction price (net of variable consideration) allocated to that performance obligation. The transaction price of goods sold and services rendered is net of variable consideration on account of various discounts and schemes offered by the Company as part of the contract.

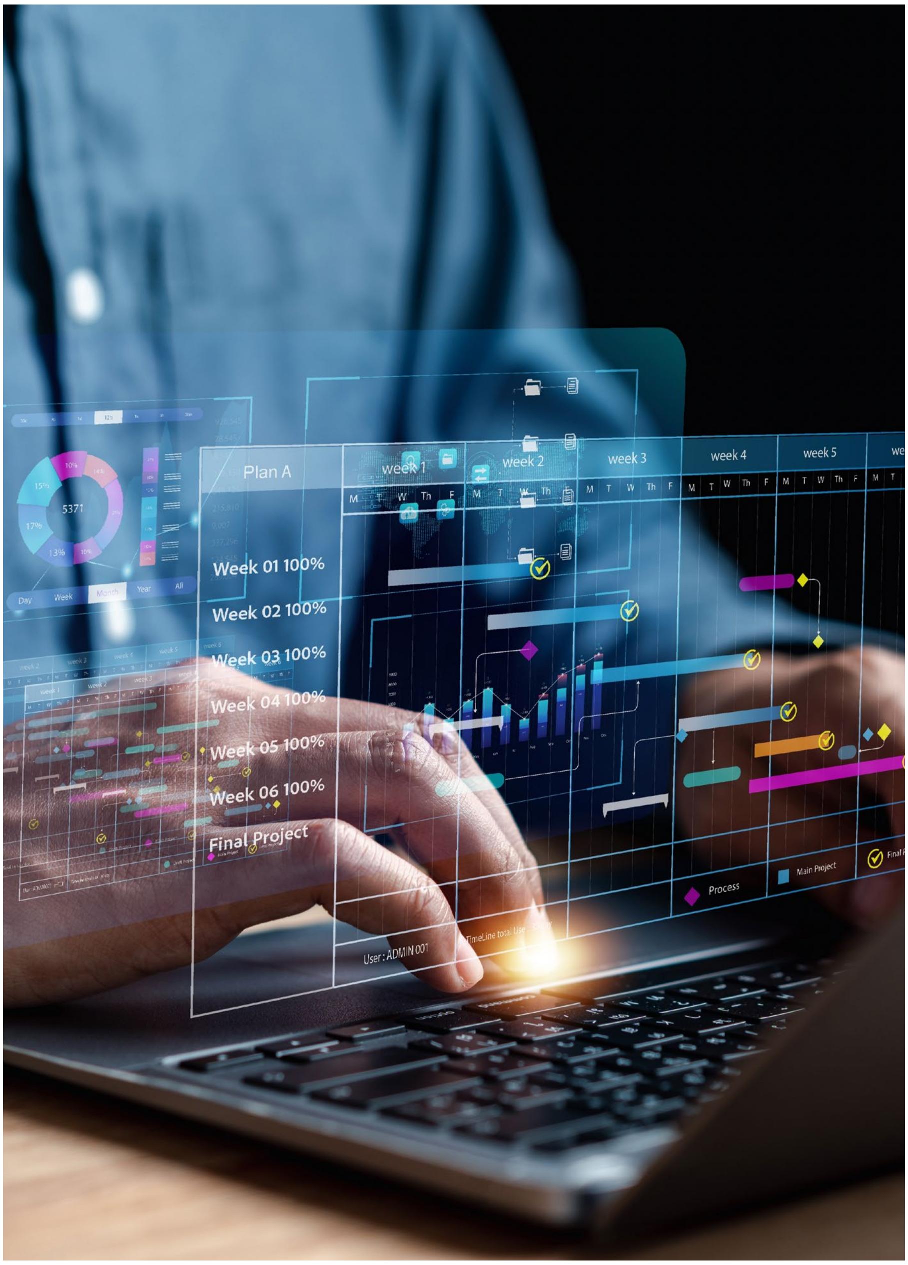
How we see it

A reporting entity conveys information about its financial position and performance through its financial statements. Effective presentation and disclosure of this information not only makes it more relevant, but it also enhances its understandability and comparability. When deciding on information disclosure, it is vital to ensure the benefits to the users outweigh the costs of providing and using the information. Non-compliance with Ind AS and Companies Act, 2013 may diminish the clarity and comparability of these statements and may not accurately represent the entity's financial status.

This critical examination by the NFRA underscores the need for companies to ensure robust and transparent financial reporting. This emphasizes the importance of transparency, compliance with regulations, adherence to financial reporting standards and clear communication of a company's financial health to users of financial statements.

Praveen Jindal

Partner, Financial Accounting Advisory Services (FAAS), EY India



Section 2

Regulatory changes

1. Key changes to Securities and Exchange Board of India (SEBI) Regulations

Amendments relating to Listing Obligations and Disclosure Requirements (LODR)

SEBI had issued Consultation Papers in November 2022 and February 2023 for amending the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR Regulations). SEBI had invited comments on these consultation papers and finally issued the amendments by way of Notification No. SEBI/LAD-NRO/GN/2023/131 dated 14 June 2023. These amendments majorly relate to enhancing disclosure and governance requirements of listed entities.

Overview of the amendments and its effective date

The amendments are effective on the 30th day of publication in the official gazette i.e., 14 July 2023, except for some of the requirements which were effective from 14 June 2023, e.g., approval requirements in case of sale, lease or disposal of an undertaking outside scheme of arrangement.

The amendments materially alter key provisions of the LODR Regulations, including the: (i) disclosure framework, by inter alia introducing objective criteria for determining material events/ information, reducing the timeline for making disclosures and mandating additional disclosures (including in relation to agreements binding listed entities and addressing market rumors), (ii) disclosure and approval requirements for special rights granted to shareholders, (iii) mandatory reasonable assurance on Business Responsibility and Sustainability Report and (iv) validity of permanent board seats and timelines for filling vacancies of directors and Key Managerial Personnels.

The objective of this article is to provide an overview of the key amendments. Reference should be made to SEBI notification dated 14 June 2023, and amended SEBI LODR Regulations, 2015, for the detailed understanding of the entire set of amendments.

A. Disclosure of material events/information under Regulations 30: Introduction of quantitative criteria for determining materiality

The qualitative criteria governing disclosure of material events/ information as per Regulation 30 (4) is where the omission in disclosure of such event/information is likely to result in:

- Discontinuing or alteration of an event or information already available publicly; or
- Significant market reaction if the said omission came to light at a later date.

Sub-regulation (4) of Regulation 30 has been amended and new quantitative criteria by way of threshold have been included for determining the materiality of events/ information as below:

The omission of an event or information, whose value or the expected impact in terms of value, exceeds the lower of the following:

- 2% of the turnover as per the last audited consolidated financial statements of the listed entity
- 2% of the net worth as per the last audited consolidated financial statements of the listed entity, except in case the arithmetic value of the net worth is negative
- 5% of the average of absolute value of profit or loss after tax, as per the last 3 audited consolidated financial statements of the listed entity

The thresholds are based on the last audited consolidated financial statements of the listed entity. Considering that the present financial year is the first year of applicability, the thresholds will need to be determined based on the consolidated financial statements as on 31 March 2023. In case of profit related parameter, average needs to be computed for the last three financial years, i.e., 2022-23, 2021-22 and 2020-21.

Turnover has been defined under Companies Act, 2013 as the gross amount of revenue recognized in the profit and loss account from the sale, supply, or distribution of goods or on account of services rendered, or both, by a company during a financial year.

'Absolute value of profit or loss after tax' means to take absolute figures of profit/loss, i.e., without netting off in case the company has losses in any of the financial year. The threshold for profit/loss is to be computed by taking the absolute values of profit or loss after tax for the immediately preceding three financial years.

The listed entity will have to ensure that the policy formulated by the listed entity for determining the materiality cannot dilute any requirement specified under the provisions of these regulations; and is required to assist the relevant employees in identifying any potential material event or information and reporting the same to authorized Key Managerial Personnels for determining the materiality of such events or information and for making necessary disclosures to stock exchange.

The new quantitative threshold would require listed entities to make timely disclosures of material information without exercising their judgement on whether they are required to be disclosed.

B. Time period for disclosure of material events/ information

The disclosure of the material event or information to the stock exchange is required to be not later than the following:

- 30 minutes from the closure of Board Meeting where the decision regarding the event/ information is taken.
- 12 hours from the occurrence of an event or information if such event or information emanates from within the listed entity.
- 24 hours from the occurrence of event or information if such event or information emanates not within the listed entity.

In case of delay in such disclosure, explanation for the same need to be disclosed. In case the timelines for the disclosure of events are specified in Part A of Schedule III of the regulations, such timelines need to be followed.

C. Amendment in Part A of Schedule III of the regulations in relation to events which needs to be disclosed basis the guidelines for materiality

The following events have been added which needs disclosure basis the guidelines for materiality:

- Arrangements for strategic, technical, manufacturing, or marketing tie-up
- Adoption of new line(s) of business
- Closure of operation of any unit, division or subsidiary (in entirety or in piecemeal)
- Pendency of any litigation(s) or dispute(s) or the outcome thereof which may have an impact on the listed entity
- Frauds or defaults by employees of the listed entity which has or may have an impact on the listed entity
- Delay or default in the payment of fines, penalties, dues, etc. to any regulatory, statutory, enforcement or judicial authority.

D. Disclosure of events/ information irrespective of materiality

Para A of Part A of Schedule III has been amended to include certain events which need to be disclosed to the Stock Exchange(s) without any application of guidelines for materiality as specified in Regulation 30(4). The events added by SEBI are listed below:

- **Event relating to fraud/ default in repayment / arrest of certain persons -**
  Fraud or defaults by a listed entity, its promoter, director, key managerial personnel, senior management or subsidiary or arrest of key managerial personnel, senior management, promoter or director of the listed entity, whether occurred within India or abroad. Default by a promoter, director, key managerial personnel, senior management or subsidiary means the default which has or may have an impact on the listed entity.
- **Event relating to restructuring / amalgamation -**
  SEBI has clarified its intent to include either 'whole or substantially the whole of the undertaking' in the ambit of restructuring, amalgamation, etc. It also extended the disclosure requirement to the sale of a stake in an associate company by the listed entity.
- **Event relating to resignation of certain persons** is required to be disclosed within seven days from the date resignation comes into effect. These certain persons include key managerial personnel, senior management, compliance officer or director other than an independent director.
- **Event relating to non-availability of certain persons –**
  The event where Managing Director or Chief Executive Officer was indisposed or unavailable to fulfill the requirements of the role in a regular manner for more than 45 days in any rolling period of 90 days, the same along with the reason for such indisposition or unavailability needs to be disclosed to the stock exchange.
- **Event relating to voluntary revision of financial statements or report of the board of directors under section 131 of the Companies Act, 2013.**

These amendments require listed entities and their management to undertake a review of all undisclosed matters. Considering materiality thresholds prescribed, entities need to assess afresh whether they now become disclosable. Listed entities will need to ensure that they have a robust mechanism for timely reporting, particularly for items that are triggered by an external action rather than voluntary actions.

Veenit Surana

Partner, Financial Accounting Advisory Services (FAAS), EY India

E. Communication from regulatory, statutory, enforcement or judicial authority

Disclosure under Regulation 30 (13)-
In case an event or information is required to be disclosed as per the provisions of this Regulation, pursuant to the receipt of a communication from any regulatory, statutory, enforcement or judicial authority, the listed entity needs to disclose such communication, along with the event or information, unless disclosure of such communication is prohibited by such authority.

Disclosure under sub-para 19 to para A of part A of Schedule III-
Action(s) initiated, or orders passed by the specified authorities against the listed entity or its directors, Key Managerial Personnels, senior management, promoter or subsidiary, in relation to the listed entity requires disclosure. These actions or orders relate to the following:

- Search or seizure; or
- Re-opening of accounts under section 130 of the Companies Act, 2013; or
- Investigation under the provisions of Chapter XIV of the Companies Act, 2013.

Disclosure under sub-para 20 to para A of Part A of Schedule III -
Action(s) taken, or orders passed by any of the specified authorities against the listed entity or its directors, Key Managerial Personnels, senior management, promoter or subsidiary, in relation to the listed entity, is also required to be disclosed.

F. Shareholders' approval of special rights

Regulation 31B has been inserted in Chapter IV, Obligations of a listed entity which has listed its specified securities and non-convertible debt securities. Any special right granted to the shareholders of a listed entity is subject to the approval by the shareholders in a general meeting by way of a special resolution once in every five years starting from the date of grant of such special right.

Special rights available to the shareholders of a listed entity as on the date of coming into force of this regulation is subject to the approval by shareholders by way of a special resolution within a period of five years from the date of coming into force of this regulation. The requirements specified in this regulation will not be applicable to the special rights made available by a listed entity to a financial institution registered with or regulated by the Reserve Bank of India under a lending arrangement in the normal course of business or to a debenture trustee registered with the Board under a subscription agreement for the debentures issued by the listed entity, if such financial institution or the debenture trustee becomes a shareholder of the listed entity as a consequence of such lending arrangement or subscription agreement for the debentures.

The amendments have been made to avoid a situation where special rights are being enjoyed by the shareholders perpetually even after significant dilution of their holdings; to avoid instances of granting special rights vide shareholder agreements by the company to the pre-IPO investors to attract investments and to maintain the principle that rights of shareholder should be proportional to his/ her holding in a company.

G. Timeline for submission of financial results subsequent to the first-time listing

Clause (j) has been added to the Regulation 33(3) of Chapter IV, Obligations of a listed entity which has listed its specified securities and non-convertible debt securities, to provide clarity on submission of financial results for the entity listed for the first time. The entity, subsequent to the listing, is required to submit its financial results for the quarter or the financial year immediately succeeding the period for which the financial statements have been disclosed in the offer document for the initial public offer, as per the below timeline:

- Period specified in Regulation 33 (3) (a) i.e., within 45 days from the end of each quarter other than the last quarter or
- Period specified in Regulation 33 (3) (d) i.e., within 60 days from the end of the Financial Year (in case of March quarter) or
- Within 21 days from the date of listing.

whichever is later.

This amendment is applicable to the issuers, whose public issues open on or after these regulations come into effect.

H. Disclosure of agreements impacting listed entities: New regulation

A new Regulation 30A has been inserted in Chapter IV, Obligations of a listed entity which has listed its specified securities and non-convertible debt securities, which require disclosures of agreements specified in the newly inserted clause 5A of para A of part A of schedule III. There are numerous agreements that are entered into by the shareholders, e.g., shareholder agreements, share purchase agreements, performance related agreements, etc. These may be entered into between investors, joint venture partners, family members, etc. These agreements may or may not be having the listed entity as a party or even a confirming party. However, these agreements pertain to management for control of the listed entity and, therefore, may require disclosure in terms of Clause 5A.

Who is required to make the above disclosures?
If the shareholders, promoters, promoter group entities, related parties, directors, key managerial personnel and employees of a listed entity or of its holding, subsidiary and associate company are parties to the above-mentioned agreement and the listed entity is not a party to such an agreement, parties to such agreement are required to make the above disclosures.

To whom and when is this information required to be disclosed?
The abovementioned person needs to inform the listed entity about the agreement within 2 working days of entering into such agreements or signing an agreement to enter into such agreements. In case these agreements subsist on the date of notification of the said clause 5A, then the above-mentioned person needs to make disclosure to the listed entity on that date only. The listed entity, in turn is required to disclose the information to the stock exchange and on its website within the timelines specified by the Board.

Information/ agreements specified in clause 5A of para A of part A of Schedule III
Agreements entered into by the shareholders, promoters, promoter group entities, related parties, directors, key managerial personnel, employees of the listed entity or of its holding, subsidiary or associate company, among themselves or with the listed entity or with a third party, solely or jointly, which, either directly or indirectly or potentially or whose purpose and effect is to, impact the management or control of the listed entity or impose any restriction or create any liability upon the listed entity, need to be disclosed to the Stock Exchanges, including disclosure of any rescission, amendment or alteration of such agreements thereto, whether or not the listed entity is a party to such agreements.

Disclosure of such information in Annual Report for FY 2023-24
Number of agreements that subsist as on the date of notification of clause 5A to para-A of part A of schedule III, their salient features, including the link to the webpage where the complete details of such agreements are available.

Information disclosed under clause 5A of para A of Part A of Schedule III needs to be disclosed in the Annual Report.

This amendment seeks to address information disparity and increases transparency. This will also enable the listed entity to be made aware of the obligations that have been imposed upon it by the parties to such agreements.

Circumstances in which disclosure of such information to the stock exchange is not required
If such agreements are entered by a listed entity in the normal course of business, unless:

- They, either directly or indirectly or potentially or whose purpose and effect is to impact the management or control of the listed entity; or
- They are required to be disclosed in terms of any other provisions of the LODR Regulations.

The term ‘directly or indirectly’ includes agreements creating an obligation on the parties to such agreements to ensure that the listed entity shall or shall not act in a particular manner.

I. Business Responsibility and Sustainability Report (BRSR): Mandatory reasonable assurance

Vide circular no. SEBI/HO/CFD/CFD-SEC-2/P/CIR/2023/122 dated 12 July 2023, SEBI has mandated reporting of ESG disclosures by top 1000 listed companies (by market capitalization) from FY 2023-24 onwards in the revised BRSR format. The revised format has added some additional questions in Section C, Principle Wise Performance Disclosures, besides making some leadership indicators as essential Indicators. To enhance the reliability of disclosures in the BRSR, SEBI has mandated the reasonable assurance of the BRSR Core (subset of BRSR) to top 150 listed entities (by market capitalization) from FY 2023-24 onwards which will be extended to top 1000 listed entities (by market capitalization) by FY 2026-27 in a phased manner vide amendment in Regulation 34 (2) (f) of the SEBI (Listing Obligations and Disclosure Requirement) Regulations, 2015 (LODR Regulations).

In addition, Key Performance Indicators (KPIs) for the value chain needs to be disclosed by the top 250 listed entities (by market capitalization) from FY 2024-25 on comply-or-explain basis. Limited assurance on the same is required to be obtained with effect from FY 2025-26. For this purpose, the value chain encompasses the top upstream and downstream partners of a listed entity, cumulatively comprising 75% of its purchases / sales (by value) respectively. SEBI has also released a set of FAQs wherein it:

- Provided an indicative list of activities which the assurance provider cannot undertake; and
- Clarified that assurance of the BRSR Core is profession agnostic.

The regulators and investors are increasingly focussing on the ESG disclosures and their accuracy. Companies need to gear up for providing adequate information in their sustainability report. As reporting and assurance of the sustainability related disclosures evolves, the audit committees have a critical role to play in expanding their existing oversight responsibilities for financial reporting and compliance to the sustainability-related disclosures.

J. Reported information in the mainstream media: New requirement

Regulation 30 (11) of SEBI (LODR) Regulation, 2015 has been amended 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, in terms of the provisions of this regulation, are circulating amongst the investing public, 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 shall also provide the current stage of such an event or information. SEBI has also defined what constitutes mainstream media 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.

How we see it

The Amendment Regulations have attempted to strengthen corporate governance standards and disclosure requirements of the listed companies. These changes reflect SEBI's commitment to create more robust regulatory framework and promote investor confidence. The changes introduced can be considered as a step in the right direction as it has the effect of empowering the shareholders of the listed companies by way of enhanced transparency and additional disclosures.

Section 3

Key hot-topics

1. Pillar Two Model accounting consideration

Background

The Organisation for Economic Co-operation and Development (OECD)/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) addresses the tax challenges arising from the digitalization of the global economy. The Global Anti-Base Erosion Model Rules ('GLoBE Rules' or 'Pillar Two Model Rules') apply to Multinational Enterprises (MNEs) with revenue in excess of €750 million per their consolidated financial statements.

The Pillar Two model rules introduce new taxing mechanisms under which MNEs would pay a minimum level of tax (the Minimum Tax). The new taxing mechanisms can impose a Minimum Tax on the income arising in each jurisdiction in which an MNE operates by imposing a Top-up Tax in a jurisdiction whenever the effective tax rate (ETR), determined on a jurisdictional basis under the GloBE Rules, is below a 15% minimum rate (Minimum Rate).

The starting point for computation of the GLoBE Tax (as per Pillar Two rules) for each constituent entity in an MNE group is the financial accounting income or loss determined under an accounting standard, followed by the Ultimate Parent Entity (UPE).

In preparing the constituent entity's financials that are compliant with the accounting standard used by the UPE and with the GloBE Tax rules, the constituent entity may need to adjust its existing records or apply standards that it has not before. The following are just a few considerations from an accounting perspective:

- A constituent entity may have to unwind the impacts of purchase accounting in certain cases. If the constituent entity has applied pushdown accounting, this may include removing those impacts.
- The constituent entity may not have performed a detailed assessment of what other entities under the control of the UPE should be consolidated specifically, by the constituent entity.
- Off-market intercompany transactions must be adjusted to consider arm's length terms for GloBE income.
- A constituent entity would also have to assess whether the minimum Tax (Top-up Tax) is an income tax in the scope of the relevant GAAP, followed by its UPE.

Key consideration:

The OECD's Pillar Two model rules are expected to radically change MNE's tax position, which would require implementation of changes in reporting systems and ensuring that data flows are ready for forecasting, reporting, disclosure, audit and ultimate compliance. Entity should develop a plan to identify the relevant data points, data owners, data gaps and data infrastructure enhancement options to facilitate timely access and seamless data conversion into regulatory information for compliance with Pillar Two rules. There has to be an alignment with the Organization's Tax Team to identify the Steering Committee to oversee Pillar Two implementation project and assessing the impact over internal controls and compliance framework.

Management of the MNE should prepare technical accounting manuals to identify and address key issues arising on account of Pillar two provisions.

The Model Rules reveal the complexity of the global minimum tax and thus, companies need to keep pace with the continuous changes that are unfolding to be able to adapt quickly. It is essential for the Companies to educate themselves on the evolving regulations and emphasizing the risks associated with potential additional tax outflows. These rules will have a comprehensive impact, not solely on the tax department but also on Finance and Information Technology department.

Amrish Darji

Director, Financial Accounting Advisory Services (FAAS), EY India

Financial Reporting considerations -

On 23 May 2023, the International Accounting Standards Board (the IASB or Board) issued International Tax Reform—Pillar Two Model Rules - Amendments to IAS 12 (the Amendments). The Board amended the standard for the following reasons: 1) to provide timely relief for affected entities; 2) to avoid diverse interpretations of IAS 12 Income Taxes developing in practice; and 3) to improve the information provided to users of financial statements before and after Pillar Two legislation comes into effect. The Amendments include:

A. Mandatory temporary exception from recognition and disclosure of deferred taxes

The temporary exception provides entities with relief from accounting for deferred taxes in relation to this complex new tax legislation, allowing stakeholders time to assess the implications. It also avoids entities in developing diverse interpretations of IAS 12 that could result in inconsistent application of the standard.

Key consideration:

An entity shall disclose that it has applied the mandatory temporary exception. Such disclosure shall form part of the accounting policy. Where there is a separate section on Pillar Two Income taxes included in the financial statements, such disclosure may be given there.

B. Disclosure of application of the exception

The Amendments require an entity to disclose that it has applied the exception to recognizing and disclosing information about deferred tax assets and liabilities related to Pillar Two income taxes.

C. Disclosure of current tax

An entity is required to separately disclose its current tax expense (income) related to Pillar Two income taxes in the periods when the legislation is effective. Entity is required to apply judgement in determining which top-up taxes it considers as income taxes in the entity's circumstances.

D. Disclosure in periods before legislation is in effect

The Amendments require that for periods in which Pillar Two legislation is (substantively) enacted but not yet effective, disclosure of known or reasonably estimable information that helps users of financial statements understand the entity's exposure arising from Pillar Two income taxes and which includes:

Other disclosure requirements for affected entities:

The proposed Amendments further requires an entity to separately disclose its current tax expense (income) related to Pillar Two income taxes. This disclosure will only be applicable in periods for which the entity earns profits assessed under Pillar Two legislation.

The Proposed amendments also require an entity to disclose:

- Qualitative information (e.g., how an entity is affected by Pillar Two legislation and the main jurisdictions where exposures exist)
- Quantitative information, such as:
  - Proportion of an entity's profits that might be subject to Pillar two income taxes
  - Average Effective Tax Rate (ETR) applicable to those profits
  - How the entity's ETR would have changed had the Pillar Two legislation been in effect.

Key consideration:

- In disclosing the potential exposure to Pillar Two income taxes, an entity needs to clearly indicate when it refers to the 'effective tax rate' as per IAS 12 and when it refers to the 'effective tax rate' in accordance with the Pillar Two requirements.
- Where Pillar Two model rules are (substantively) enacted close to the reporting date or the date of issuance of the financial statements, an entity might not be able to provide any known or reasonably estimable information, in such a situation, the fact is to be disclosed.
- Intermediate parents and subsidiaries of an MNE group need to apply judgement in determining whether or not in a particular situation a 'top-up' tax meets the definition of an income tax in Ind AS 12 and disclose those judgements in accordance with Ind AS 1. If the entity concludes that such taxes are outside the scope of Ind AS 12, then the entity shall consider disclosing information in line with Ind AS 1.
- Comparative information for current tax expense (income) is not required to be restated in the first year of legislation becoming effective.

How we see it

Pillar Two income taxes rules has not been notified in India yet, but many countries have already taken part in this global initiative. Currently, the entities which are part of global jurisdictions where the amendment has already been adopted, need to get ready to provide the additional disclosures (both qualitative and quantitative information) about its exposure to Pillar Two income taxes at the end of the reporting period. To the extent the information is not known, the entities will be required to make a statement to that effect and describe their progress in assessing their exposure. Entities also need to monitor the developments around the implementation and (substantive) enactment of the Pillar Two model rules in the relevant jurisdictions.

Entities should start considering whether they have established appropriate processes and procedures to obtain the information necessary to present the disclosures required by the amendments. These amendments to the IFRS are applicable for annual reporting periods beginning on or after 1 January 2023, but not for any interim periods ending on or before 31 December 2023.

Similarly, in line with amendment in IAS 12, ICAI has issued Exposure Drafts (ED) to Ind AS 12 pursuant to Pillar Two Model rules introduced by BEPS.

How we see it

It is expected that Pillar Two Model rules will be implemented and effective, beginning in 2024 for most jurisdictions. Entities need to monitor the developments around the implementation and (substantive) enactment of the Pillar Two model rules in the relevant jurisdictions and need to get ready to provide the additional disclosures required by the amendments to IAS 12 in a timely manner. Entities should be prepared to provide qualitative and quantitative information about their exposure to Pillar Two income taxes at the end of the reporting period. To the extent that information is not known or estimable, entities will be required to make a statement to that effect and describe their progress in assessing their exposure.

Affected MNEs' need to put processes and controls in place to gather the data, prepare the calculations, and determine the appropriate reporting. This may require design changes to existing tax provision processes and updates to internal control documentation.

2. Key considerations for presentation of reverse factoring arrangement in the balance sheet, statement of cash flows and notes to the financial statements

Supplier finance arrangements are often referred to as supply chain finance, payables finance or reverse factoring arrangements. Arrangements that are solely credit enhancements for the entity (for example, financial guarantees including letters of credit used as guarantees) or instruments used by the entity to settle directly with a supplier the amounts owed (for example, credit cards) are not supplier finance arrangements. In such arrangements, generally a financial intermediary, viz., bank agrees to make upfront payment for amounts owed by an entity to its suppliers and the entity will make payment to the bank at a date later when payment to the suppliers is due or at the end of extended credit period.

These arrangements may take various forms and terms and conditions of these arrangements may also vary significantly. Based on our understanding, given below are typical features of a common supplier finance arrangement:

1. Involvement of a purchaser of goods/ services, a group of its suppliers and a financial intermediary (bank) who enter into a tri-partite or a series of bilateral agreements.
2. Purchaser is often a large, creditworthy entity that uses a number of suppliers, many of which will have a higher credit risk/ lower credit worthiness than the purchaser.
3. Arrangement is generally initiated by the purchaser as against the supplier.
4. In many cases, these arrangements are put in place so that the purchaser gets extended payment terms from its suppliers. However, in other cases, the purpose may simply be to secure early payment for the supplier.
5. Bank makes available to suppliers invoice discounting or factoring facility for invoices accepted by the purchaser.
6. Purchaser will commit to pay the invoice on the due date or at the end of extended credit period.
7. Interest and cross-default terms are included in the agreement to protect the bank in the event of the purchaser defaulting or missing the payment date.
8. Generally, the bank considers credit risk of the purchaser to decide minimum interest rate, but it may still be able to charge somewhat higher financing cost to the supplier (as discount charge).
9. It can be difficult to determine the overall financing costs of the arrangement, and who bears those costs, especially if the supply involves items for which the pricing is subjective/ unobservable.

Key accounting considerations

With regard to payables covered under such arrangements, the following key questions arise:

a) How should such payable be presented in the balance sheet and the key considerations to decide such a presentation?

b) How should cash flows related to such arrangements be presented in the statement of cash flows of the purchaser?

c) Are there any disclosures required for such arrangements in notes for the financial statements?

A. Presentation in the balance sheet

There is no single Ind AS which deals with accounting/ presentation of such arrangements. In this regard, IFRIC Agenda decision was published in 2020. Although it was issued in the context of IFRS, but is substantially aligned to Ind AS except that Schedule III to the Companies Act, 2013 contains additional requirements for presentation of financial statements. A cumulative understanding of the underlying principles covered in this guidance is given below:

Ind AS 1 presentation of financial statements requires separate presentation of trade and other payables from financial liabilities. It also requires presentation of separate line item based on size, nature, and function of an item.

Format of balance sheet given in Schedule III to the Companies Act, 2013 requires borrowings, trade payables and other financial liabilities to be presented separately on the face of the balance sheet. Whilst Schedule III to the Companies Act, 2013 requires separate presentation of borrowings on the face of the balance sheet, neither Ind AS nor Schedule III nor Guidance Note on Division II - Ind AS Schedule III to the Companies Act, 2013 defines the term borrowing. However, Schedule III contains a list of items to be included/ presented under the head borrowing. Also, the Guidance Note on Division II - Ind AS Schedule III to the Companies Act 2013 and Ind AS 37 Provisions, Contingent Liabilities and Contingent Assets, contain guidance on liabilities to be included under the head trade payable.

In addition to the above, Ind AS 109 Financial Instruments contains specific guidance on when an entity needs to derecognize old liability and recognize new liability.

Considering the requirements, an entity will need to evaluate carefully and determine whether it should present liabilities that are part of a supplier finance arrangement:

- Within trade payables
- Within borrowings
- Within other financial liabilities/ as a separate line item on the face of the balance sheet

The above evaluation is not an accounting policy choice but requires exercise of judgment basis evaluation of terms of the arrangement and relevant guidance.

In our view, amount payable and covered under supplier finance arrangement can continue to be presented as trade payable only if the entity's trade payables do not meet derecognition criteria of Ind AS 109 on payable getting covered under such arrangement and such payable:

- Represents a liability to pay for goods and services
- Is invoiced and formally agreed with the supplier
- Is part of the working capital used in its normal operating cycle

The entity will apply Ind AS 109 requirements to assess whether and when to derecognize trade payable and recognize a new liability at its fair value with resulting impact in the statement of profit and loss. Under Ind AS 109, an entity will need to derecognize trade payable and recognize a new liability if:

- The entity is legally released from its original obligation to the supplier, and it assumes a new obligation toward another party, say, bank.
- Derecognition can also occur if the purchaser is not legally released from the original obligation, but the terms of the obligation are amended in a way that is considered a substantial modification.

Based on an evaluation of derecognition requirements as well as other aspects stated above, if an entity concludes that presentation as trade payable is no longer justified, then it should evaluate other appropriate presentation of such liability, i.e., as borrowing, separate line item or as part of other financial liability.

B. Presentation in the statement of cash flows

In respect of the presentation in the statement of cash flows, an entity that has entered into a supplier finance arrangement would need to determine whether to classify cash flows under the arrangement as cash flows from operating activities or cash flows from financing activities. This, in turn poses the following challenges:

- Should the remittance of cash directly to the supplier by the bank be reflected at all in the statement of cash flow, or is it a non-cash transaction?
- Should the presentation of the liability to the bank in the balance sheet impact the presentation of cash flows?

With regard to the first question above, if no cash inflow or cash outflow occurs for an entity in a financing transaction, the entity discloses the transaction elsewhere in the financial statements in a way that provides all the relevant information about the financing activity (Para 43 of Ind AS 7).

With respect to the second question above, if the entity considers the related liability to be a trade payable or other financial liability/ separate line item that is still part of the working capital used in the entity's principal revenue-producing activities, the entity presents cash outflows to settle the liability as arising from operating activities in its statement of cash flows. In contrast, if the entity considers that the related liability is neither a trade payable nor part of the working capital because the liability represents borrowings/ other financing of the entity, the entity presents cash outflows to settle the liability as arising from financing activities in its statement of cash flows.

C. Disclosure in notes to financial statements

Existing Disclosures required under Ind AS

With regard to supplier finance arrangement, the following disclosures required under Ind AS may be particularly relevant:

a) Since an entity applies judgement in determining appropriate presentation of payable in the balance sheet and cash flow statement and it may have a material impact on financial statements, the following disclosures may be relevant:

  (i) An entity discloses judgements that management has made in this respect if they are among the judgements made that have the most significant effect on the amounts recognized in the financial statements (para 122 of Ind AS 1).

  (ii) An entity provides information about reverse factoring arrangements in its financial statements to the extent that such information is relevant to an understanding of those financial statements (para 112 of Ind AS 1)

b) Para 44A of Ind AS 7 requires an entity to provide 'disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes.' Such a disclosure is required for liabilities that are part of a supplier finance arrangement if the cash flows for those liabilities were, or future cash flows will be, classified as cash flows from financing activities.

c) Para 33-35 of Ind AS 107 require an entity to disclose how exposures to risk arising from financial instruments including liquidity risk arise, the entity's objectives, policies and processes for managing the risk, summary quantitative data about the entity's exposure to liquidity risk at the end of the reporting period (including further information if this data is unrepresentative of the entity's exposure to liquidity risk during the period), and concentrations of risk. Para 39 and B11F of Ind AS 107 specify further requirements and factors an entity might consider in providing liquidity risk disclosures. Since reverse factoring arrangements often give rise to liquidity risk, the above discussed disclosures are required for such arrangements.

Proposed disclosures under Ind AS

It has been observed that information entities provide about supplier finance arrangements applying existing requirements does not meet all the information needs, which would allow the users of the financial statements to fully understand the arrangement in place and the associated risks. Therefore, the ICAI has issued Exposure Draft (ED) on amendments to Ind AS 7 and Ind AS 107 to increase the level of disclosure and transparency about entities' supplier finance arrangements, on the lines of the amendments to IAS 7 Statement of Cash Flows and IFRS 7 Financial Instruments: Disclosures proposed by IASB. The proposed disclosures are likely to be effective for financial year beginning on 1 April 2024.

Amendments to Ind AS 7

The ED proposes the following disclosure for supplier finance arrangements:

- Terms and conditions of the arrangements
- As at the beginning and end of the reporting period:
  - The carrying amounts of supplier finance arrangement, financial liabilities and the line items in which those liabilities are presented.
  - The carrying amounts of financial liabilities and the line items for which the finance providers have already settled the corresponding trade payables.
  - The range of payment due dates for financial liabilities owed to the finance providers and for comparable trade payables that are not part of those arrangements.
- The type and effect of non-cash changes in the carrying amounts of supplier finance arrangement financial liabilities, which prevent the carrying amounts of the financial liabilities from being comparable.

The proposed amendments will require an entity to aggregate information about its supplier finance arrangements. However, the entity must disaggregate information about unusual or unique terms and conditions of individual arrangements when they are dissimilar. Explanatory information about payment due dates, when those payment due date ranges are wide, must also be disaggregated.

How we see it

Whilst reverse factoring arrangements are not new, they have gained more prominence in recent years. There are many variations of reverse factoring arrangements. Accordingly, the presentation in financial statements may also change. For a smooth transition and compliance with the amendments, entities should prepare by reviewing existing contracts, systems and discussing it with their finance providers and auditors.

With the rising popularity of supplier finance arrangements facilitating quicker invoice payments, companies are required to cautiously determine how these arrangements are represented in their financial statements. This process demands careful judgement considering the terms of the arrangement and relevant guidelines under Ind AS and Schedule III Division II. Understanding whether these arrangements should be classified as trade payables or borrowings is crucial. This ensures accurate financial reporting, maintaining clarity and compliance with set standards.

Dr. Devesh Prakash

Partner, Financial Accounting Advisory Services (FAAS), EY India

3. Accounting consideration arising from geopolitical and economic uncertainty

Current economic environment

Geopolitical concerns and conflicts around the world continue to impact entities globally. Economic volatility has continued in 2023 and globally, core inflation and interest rates remain high, impacting commodity and energy prices, foreign exchange rates and other macroeconomic factors. Therefore, the global economic outlook remains highly uncertain, and entities and teams need to consider the effects on financial reporting, including the extent of disclosures required in annual financial statements.

Accounting considerations

A. Asset impairment

a) Non-current assets
When performing an impairment test, entities are required to determine the recoverable amounts of the assets, being the higher of fair value, less costs of disposal (FVLCD) and value in use (VIU). The estimation of VIU involves the estimation of cashflows derived from the use of the asset and discounting them at an appropriate rate. Significant increase in interest rates may affect entities' discount rate when using the discounted cash flow model. When significant uncertainty exists and judgement is required, an expected cash flow approach based on probability-weighted scenarios may be more appropriate than a single best estimate for estimating value in use.

b) Inventories
Ind AS 2 generally requires entities to account for inventories at the lower of cost and net realizable value. Increases in commodity prices and supply chain disruptions for certain raw materials and component parts are contributing to inflation, which could result in higher costs that are capitalized into inventory. If an entity is unable to pass higher costs on to customers, the carrying amount of the inventory might not be recoverable and the entity might be required to write the inventory down to its net realizable value.

c) Equity accounted investment
Entities will need to consider whether the current economic environment, including high inflation and interest rates, indicates that the carrying amount of equity accounted investments may not be recoverable and therefore require an impairment test.

B. Financial instruments

a) Derivative and hedge accounting
Entities looking to protect themselves from rising interest rates may enter into interest derivatives or non-interest derivatives to hedge themselves against rising energy and commodity prices.

Entities that hold derivative instruments, in particular, interest rate derivatives, may experience substantial gains or losses, which could affect collateral requirements, liquidity, profit and loss, or OCI, and consequently, equity. In addition, changes in a derivative counterparty's credit risk or an entity's own non-performance risk could affect fair value estimates of derivatives, as well as hedge effectiveness assessments for derivatives that are designated as hedging instruments. The current market conditions may result in the discontinuation of hedge accounting.

b) Expected credit losses
Entities will need to consider the current economic environment and the requirements in Ind AS 109 when measuring expected credit losses on assets such as loans, trade receivables and contract assets. Inflation and high interest rates may adversely impact the ability of borrowers to repay their debts and, therefore, could trigger impairment losses. The impact of the current economic environment should be incorporated into the ECL in a way that reflects an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes.

c) Contract modifications
Affected entities may experience cash flow challenges as a result of disruptions in their operations. Such entities may need to obtain additional financing, amend the terms of existing debt agreements or obtain waivers if they no longer satisfy debt covenants. In such cases, they will need to consider the guidance provided in Ind AS 109 to determine whether the changes represent a substantial modification or potentially a contract extinguishment.

d) Own use exemptions
Entities that have revised their expectations on purchases or sales of nonfinancial items due to the current economic environment, should consider how these changes affect the classification and measurement of such contracts and whether they continue to meet the so called 'normal purchase or sale exception' in Ind AS 109

C. Revenue recognition

Entities will need to consider the effects on their Ind AS 115 collectability assessments, estimates of variable consideration made at contract inception, the subsequent impairment measurement of any contract assets or trade receivables under the expected credit loss model in Ind AS 109, as well as impairment of related contract cost assets.

The effect of inflation and rising commodity rates can affect the measure of progress for performance obligations satisfied over time that apply a cost-based input method. Entities need to ensure that the measure of progress appropriately reflects their performance in transferring control of the promised good or service to the customer, which could require judgement. Uncertainty might prompt entities to modify contracts with customers and required modification accounting as per Ind AS 115.

D. Provisions

The amount recognized as a provision is the best estimate of the expenditure required to settle the present obligation at the end of the reporting period, which could be a higher amount than previously expected as a result of inflation and rising costs.

a) **Discount rate:**
   Entities may need to consider the effects of high inflation and interest rates on the measurement of provisions with regards to the discount rate used. The discount rate to be used depends on whether: (a) The future cash flows are expressed in current prices, in which case, a real discount rate (which excludes the effects of general inflation) is used or (b) The future cash flows are expressed in expected future prices, in which case, a nominal discount rate (which includes a return to cover expected inflation) is used.

b) **Onerous contract:**
   When there is high inflation, entities that have not fixed their costs to fulfill their obligations under contracts or are not able to pass on the effects of price increases to their customers may need to consider the existence of an onerous contract provision.

c) **Restructuring provision:**
   Restructuring activities are more common in times of economic uncertainty involving high inflation and interest rates. Ind AS 37 provides that only direct costs arising from the restructuring, such as employee termination benefits that relate directly to the restructuring (treated under Ind AS 19), contract termination costs, etc. Costs related to preparing the business to operate after the restructuring are not eligible for inclusion in any provision.

d) **Future operating losses:**
   Ind AS 37 prohibits recognition of provisions for future operating costs or future business recovery costs. As entities may anticipate future operating losses stemming from the impact of inflation, they cannot be provided for in advance of the transactions having taken place.

The uncertainty surrounding the global economic outlook requires entities to assess the effects and risks on their Ind AS financial reporting. They should also consider the extensive disclosures required in their annual financial statements, reflecting the evolving economic conditions and their risk management strategies.

Ayush Agarwal
Partner, Financial Accounting Advisory Services (FAAS), EY India

How we see it

Entities may need to consider the impact of increased borrowing costs on measurement of assets and liabilities, impairment calculations, provisions, retirement obligations, leases, financial instruments, etc. Inflation also affects many other areas of accounting, such as determining the net realizable values of inventories. Further, the current economic environment may lead entities to take business decisions to substantially curtail operations, modify or terminate employee benefits and ESOP schemes, etc. Accounting implications of such decisions would have to be carefully analyzed and give effect in accordance with the accounting standards.

EY offices

Ahmedabad
22nd Floor, B Wing, Privilon
Ambli BRT Road, Behind Iskcon
Temple, Off SG Highway
Ahmedabad - 380 059
Tel: + 91 79 6608 3800

Bengaluru
12th & 13th floor
"UB City", Canberra Block
No. 24, Vittal Mallya Road
Bengaluru - 560 001
Tel: + 91 80 6727 5000

Ground Floor, 'A' wing
Divyasree Chambers
11, Langford Gardens
Bengaluru - 560 025
Tel: + 91 80 6727 5000

Chandigarh
Elante offices, Unit
No. B-613 & 614
6th Floor, Plot No- 178-178A
Industrial & Business
Park, Phase-I
Chandigarh - 160 002
Tel: + 91 172 6717800

Chennai
Tidel Park, 6th & 7th Floor
A Block, No.4, Rajiv Gandhi Salai
Taramani, Chennai - 600 113
Tel: + 91 44 6654 8100

Delhi NCR
Ground Floor
67, Institutional Area
Sector 44, Gurugram - 122 003
Haryana
Tel: +91 124 443 4000

3rd & 6th Floor, Worldmark-1
IGI Airport Hospitality District
Aerocity, New Delhi - 110 037
Tel: + 91 11 4731 8000

4th & 5th Floor, Plot No 2B
Tower 2, Sector 126
NOIDA - 201 304
Gautam Budh Nagar, U.P.
Tel: + 91 120 671 7000

Hyderabad
THE SKYVIEW 10
18th Floor, "SOUTH LOBBY"
Survey No 83/1, Raidurgam
Hyderabad - 500 032
Tel: + 91 40 6736 2000

Jamshedpur
1st Floor, Fairdeal Complex
Holding No. 7, SB Shop Area
Bistupur, Jamshedpur - 831 001
East Singhbhum Jharkhand
Tel: + 91 657 663 1000

Kochi
9th Floor, ABAD Nucleus
NH-49, Maradu PO
Kochi - 682 304
Tel: + 91 484 304 4000

Kolkata
22 Camac Street
3rd Floor, Block 'C'
Kolkata - 700 016
Tel: + 91 33 6615 3400

Mumbai
14th Floor, The Ruby
29 Senapati Bapat Marg
Dadar (W), Mumbai - 400 028
Tel: + 91 22 6192 0000

5th Floor, Block B-2
Nirlon Knowledge Park
Off. Western Express Highway
Goregaon (E)
Mumbai - 400 063
Tel: + 91 22 6192 0000

Pune
C-401, 4th floor
Panchshil Tech Park
Yerwada
(Near Don Bosco School)
Pune - 411 006
Tel: + 91 20 4912 6000

Ernst & Young Associates LLP

EY | Building a better working world

EY exists to build a better working world, helping to create long-term value for clients, people and society and build trust in the capital markets.

Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via ey.com/privacy. EYG member firms do not practice law where prohibited by local laws. For more information about our organization, please visit ey.com.

Ernst & Young Associates LLP is one of the Indian client serving member firms of EYGM Limited. For more information about our organization, please visit www.ey.com/en_in.

Ernst & Young Associates LLP is a Limited Liability Partnership, registered under the Limited Liability Partnership Act, 2008 in India, having its registered office at 6th Floor, Worldmark-1, Asset Area 11, Hospitality District, Indira Gandhi International Airport, New Delhi-110037, India.

EYIN2404-014
ED None

SJ

ey.com/en_in

@EY_India EY EY India EY Careers India @ey_indiacareers