Year-end considerations

Updates of standards, interpretations and regulatory considerations affecting financial statements

April 2023

Click to enter

EY

Building a better working world

We acknowledge contributions from:

- Adarsh Ranka
- Jigar Parikh
- Dr. Devesh Prakash
- Jalpa Sonchhatra
- Ayush Agrawal
- Veenit Surana
- Deepa Agarwal
- Basudev Kalauni
- Amrish Darji
- Nikita Samant
- Ashish Karani
- Sajjadhussein Mistry
- Pooja Chothave
- Hiral Valia
- Akshay Ramani
- Bushra Madraswala
- Lavtej Ahuja
- Rashika Kewte
- Ameya Tandel
- Mansi Sampat

Foreword

As we revisit the Financial Year 2022-23, number of challenges are likely to shape the future landscape such as sharp deterioration of macroeconomic environment with geopolitical risks, high inflation, monetary measures by central banks, slowing economic growth and the potential for a full-blown recession in many countries. The war between Russia and Ukraine has already catalyzed enormous disruption for businesses and economies around the globe. The emergence of COVID-19 pandemic, the war between Russia and Ukraine, multi-decade high interest rates, depressed global equity prices, elevated market volatility, and a synchronized slowdown in Europe, Latin America, North America, and Asia will likely push the global economy into a recession in upcoming years. Global IPO activity was also impacted due to these unfavorable market conditions, along with the dismal performance of many IPOs that had been listed earlier.

Regulatory changes are reflection of these challenges and uncertainties. In seeking to address and mitigate the risks of this new environment, regulators may create an additional layer of complexity for industry from the perspective of its inclusion in financial statements. At the same time, by anticipating regulatory changes, industry can unlock new growth areas and reinforce competitive advantages. This publication aims to help Companies make sense of the regulatory landscape that is relevant for FY2022-23 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 2023, 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 2023, which are relevant for financial year 2022-23 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 2023 and certain key amendments that are applicable for financial statements for the year-ended 31 March 2023 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 2023 and beyond.

Hope you all find the publication useful.

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

Contents

Section 1: New accounting pronouncements relevant for financial statements of FY 2022-23 or thereafter 05

1. Overview of key amendments to Indian Accounting Standards (Ind AS) 06
2. Summary of Expert Advisory Committee (EAC) Opinions 08
3. IFRS Interpretations Committee Discussion (IFRS IC) 15
4. Implementation of reporting requirement under Companies (Audit and Auditors) Rules, 2014 [11(e) and 11(f)] 21
5. Presentation and Disclosures - Key consideration 23
6. Clarification issued by National Financial Reporting Authority 26

Section 2: Regulatory changes 28

1. Ministry of Corporate Affairs (MCA) notification 29
   a. Use of an accounting software which records audit trail 29
   b. Corporate Social Responsibilities (CSR) 30
   c. Other amendments 32
2. Key changes to Securities and Exchange Board of India (SEBI) Regulations 32
   a. Amendment to Related Party disclosures 32
   b. Amendment relating to SEBI Listing Obligations and Disclosure Requirement (LODR) 33
   c. Amendment relating to Issue of Capital and Disclosure Requirements (ICDR) 36

Section 3: Key hot- topics 39

1. Accounting matters on account of political and economic uncertainty 40
2. Climate related matters in financial statements 41
3. Accounting for Production Linked Incentive (PLI) Scheme 43

Section 1

New accounting pronouncements relevant for financial statements of FY 2022-23 or thereafter

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

Companies (Indian Accounting Standards) Amendment Rules, 2022

Background

MCA vide its Notification dated 23 March 2022 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 2022. Following is the summary of changes:

Ref to std	Key requirements	Key considerations
Ind AS 103 Business Combinations	Ind AS 103 specifies that assets and liabilities recognized in a business combination must meet the respective definitions of assets and liabilities in the Framework for the Preparation and Presentation of Financial Statements in accordance with Ind AS, issued by the ICAI. After the acquisition date, an acquirer accounts for most types of assets and liabilities recognized in a business combination in accordance with other Ind AS standards applicable to those items. In the amendment notification of Ind AS 103, the Framework for the Preparation and Presentation of Financial Statements in accordance with Ind AS has been replaced by the Conceptual Framework for Financial Reporting under Ind AS. To address this matter, consequential wordings in Ind AS 103 have also been changed. It may be noted that there are certain differences in the definition of asset and liability under the Framework and the Conceptual Framework, which may have caused some unintended consequences in the financial statements post business combination accounting. To avoid such unintended consequences, other appropriate changes in requirements related to contingent liability and contingent asset recognition have been made. The amendments add an exception to the recognition principle of Ind AS 103 to avoid the issue of potential 'day 2' gains or losses arising for liabilities and contingent liabilities that would be within the scope of Ind AS 37 Provisions, Contingent Liabilities and Contingent Assets or Appendix C, Levies of Ind AS 37, if incurred separately. The exception requires entities to apply the criteria in Ind AS 37, instead of the Conceptual Framework, to determine whether a present obligation exists as at the acquisition date. Ind AS 103 prohibits the recognition of contingent assets acquired in a business combination. This prohibition was not, however, explicitly stated in Ind AS 103. A new para has been added to Ind AS 103 to clarify that contingent assets do not qualify for recognition at the acquisition date.	The amendments are intended to update reference to the Conceptual Framework without significantly changing requirements of Ind AS 103.
Ind AS 16 Property Plant and Equipment (PPE)	The amendment has clarified that excess of net sale proceeds of items produced over the cost of testing (while bringing the asset to that location and condition) shall not be recognized in the profit or loss but deducted from the directly attributable costs considered as part of cost of an item of Property, Plant, and Equipment.	This amendment is carveout from IAS 16, Property, Plant and Equipment which requires proceeds from selling those items before the corresponding PPE item is available for use to be recognized in the statement of profit and loss account. The clarification provides the necessary guidance on accounting treatment.

Ref to std	Key requirements	Key considerations
Ind AS 37 Provisions, Contingent Liabilities and Contingent Assets	The amendments specify which costs an entity needs to include when assessing whether a contract is onerous or loss-making. The amendments apply a 'directly related cost approach'. The costs that relate directly to a contract to provide goods or services include both incremental costs (e.g., the costs of direct labor and materials) and an allocation of costs directly related to contract activities (e.g., depreciation of equipment used to fulfil the contract as well as costs of contract management and supervision). General and administrative costs do not relate directly to a contract and are excluded unless they are explicitly chargeable to the counterparty under the contract. The amendments must be applied to contracts for which an entity has not yet fulfilled all its obligations at the beginning of the annual reporting period in which it first applies the amendments. Comparative information shall not be restated. Instead, the cumulative effect of initially applying the amendments is recognized as an adjustment to the opening balance of retained earnings or other component of equity, as appropriate, at the date of initial application.	The amendments are intended to provide clarity and help ensure consistent application of the standard. Entities that previously applied the incremental cost approach will see provisions increase to reflect the inclusion of costs related directly to contract activities. Judgement will be required in determining which costs are 'directly related to contract activities'.
Ind AS 109 Financial Instruments	Clarification added to specify which fees are included in the 10 percent test for consideration of substantial modification: ▶ In determining those fees paid net of fees received, a borrower includes only fees paid or received between the borrower and the lender, including fees paid or received by either the borrower or lender on the other's behalf. An entity applies the amendment to financial liabilities that are modified or exchanged on or after the beginning of the annual reporting period in which the entity first applies the amendment.	The amendment clarifies the fees that an entity includes when assessing whether the terms of a new or modified financial liability are substantially different from the terms of the original financial liability. These fees include only those paid or received between the borrower and the lender, including fees paid or received by either the borrower or lender on the other's behalf.
Ind AS 101 First-time adoption of Indian Accounting Standards	Additional exemption: If a subsidiary becomes a first-time adopter later than its parent, ▶ It can measure Cumulative Translation Differences (CTDs) for all foreign operations at the carrying amount as per parent CFS, based on the parent's date of transition to Ind ASs, if It elects to measure carrying value of assets and liabilities as per Parent CFS ▶ A similar election is available to an associate or joint venture that uses the exemption in paragraph D16(a).	The amendment permits a subsidiary that elects to apply paragraph D16(a) of Ind AS 101 to measure cumulative translation differences using the amounts reported in the parent's consolidated financial statements, based on the parent's date of transition to Ind AS, if no adjustments were made for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary. This amendment is also applied to an associate or joint venture that elects to apply paragraph D16(a) of Ind AS 101.
Ind AS 41 Agriculture	Removed the requirement to exclude cash flows for taxation when measuring fair value, thereby aligning the fair value measurement requirements in Ind AS 41 with those in Ind AS 113.	The amendment removes the requirement of Ind AS 41 that requires entities to exclude cash flows for taxation when measuring the fair value of assets within the scope of Ind AS 41.

Most of these Ind AS amendments are notified by MCA to keep the Ind AS converged with the IFRS except for an amendment to Ind AS 16, Property, Plant and Equipment. Ind AS 16 amendment is at variance from IFRS and will create an additional carve-out vis-à-vis IFRS. Some of these changes may require companies to evaluate the current accounting and incorporate the impact carefully.

Ayush Agrawal

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

2. Summary of Expert Advisory Committee (EAC) opinions

EAC-1 Accounting treatment of borrowing costs incurred by parent company in respect of borrowings made for acquisition of investments in subsidiary company

Background

A company is in the business of exploration and production (E&P) of oil and gas and other hydrocarbon related activities. The Company acquired 60% shares in subsidiary company X. At the time of acquisition of the shares in subsidiary company X, the company was holding 10% participating interest (PI) in an oil and gas asset under development. The purchase consideration for the acquisition was financed partly by market borrowings and partly by internal accruals.

The finance cost incurred on the borrowings made for acquisition of shares in subsidiary X was charged to P&L by the company in Standalone Financial Statements (SFS) as well as Consolidated Financial Statements (CFS).

Comptroller and Auditor General of India (C&AG) was of view that borrowing cost should be capitalized in CFS basis the FAQ 22 of Educational Material on Ind AS 110 on the capitalization of finance cost for the amount borrowed for holding the equity investment in its subsidiary.

Whether the approach followed by a company in its SFS and CFS for charging the finance cost to P&L is appropriate and is in line with the requirement of Ind AS 23 and Ind AS 110.

EAC view

As per FAQ 22 on Education Material on Ind AS 110, it was clarified that interest payment on loan taken by the holding company for equity investment in its wholly owned subsidiary company and loan was for construction of an asset in a subsidiary company. The said asset meets the definition of a qualifying asset under Ind AS 23 and therefore, from the perspective of CFS, the reporting entity (i.e., the group) has raised a loan from an external party and has used the proceeds of the loan to finance the construction of a qualifying asset. Hence, to the extent the borrowing costs associated with the loan are directly attributable to the construction of the qualifying asset, the same should be included in the cost of the asset in the consolidated financial statements of the holding company.

Also, the Company has acquired the shares of the subsidiary company X in a secondary transaction and the subsidiary company did not receive any funds from the Company (paid to the previous investor from whom the shares acquired). There is no direct relationship between the borrowings made by the Company and the expenditure incurred on development of the qualifying asset.

The borrowing costs incurred cannot be capitalized in CFS, since funds paid by the Company were not directly used for acquisition of oil and gas project under development, rather these were used for acquisition of shares which cannot be considered as a qualifying asset. Further in SFS capitalization question does not arise as asset recognized is an investment and not the oil and gas project under development.

On the basis of above, EAC opined that the borrowing costs incurred on acquisition of shares of subsidiary company in a secondary transaction cannot be capitalized either in the SFS or in the CFS of the Company.

EAC-2 Presentation of interest earned from deployment of surplus funds with banks

Background

A Company is engaged in the business of planning, developing, and executing the suburban railway transportation needs of Mumbai Metropolitan Region. The project to be executed by the Company is called the Mumbai Urban Transport Project (MUTP). The Company has been incorporated as a project executing agency. As per terms of MoU/Agreements, the ownership of all the operating assets created by the Company under MUTP remains with the Indian Railways.

The funds received for executing the MUTP project from the Ministry of Railways (MoR) and Government of Maharashtra (GoM) are accounted for as 'Funds received for MUTP Works' and are presented under 'Other Long-Term Liabilities' and funds utilized on the creation of MUTP assets are accounted for as 'Funds utilized on MUTP' and presented as a reduction from 'Funds received for MUTP' under 'Other Long-Term Liabilities' in the financial statements. So, effectively the net balance, i.e., excess of funds received for MUTP over funds utilized on MUTP appears as 'Other Long-Term Liability' in the financial statements of the Company.

A major part of MUTP is directly carried out by the Company for which the Company receives Direction and General (D&G) Charges. D&G Charges are charges fixed by MoR in percentage terms of the amount spent on MUTP and this percentage is based on the nature, type and complexities of the relevant project involved and experiences of the execution of the project of the same size and nature. In addition to revenues received by way of D&G Charges, the Company also earns interest on funds temporarily deployed with Scheduled Banks, pending the funds' utilization in MUTP.

Direction and General Charges are nothing but reimbursement of cost which the Company incurs on executing the project; it is very important to note here that while deciding such percentage of Direction and General Charges payable to the Company, the MoR also considers the approximate amount of interest, which the Company may earn on the deployment of surplus funds during the execution of the concerned project. Thus, D&G Charges and interest, both, form part of the total estimated revenue required by the Company to incur the estimated establishment cost to execute a particular MUTP Project. Hence, interest, just like D&G Charges, invariably becomes part of the revenue from operating activities of the Company. Considering the above facts and unique circumstances, the Company is of the view that such interest earned shall be classified as 'other operating revenue', if not 'operating revenue' of the Company.

The querist has sought an opinion of EAC on whether accounting and presentation of interest earned as a part of 'other operating revenue' is correct under Guidance Note on Division I – Non Ind AS Schedule III to the Companies Act, 2013.

EAC view

EAC noted that as per the requirements of the Guidance Note on Division I – Non Ind AS Schedule III to the Companies Act, 2013, (Revised July 2019 Edition), issued by the Institute of Chartered Accountants of India, (ICAI) 'other operating revenue' includes revenue arising from a company's operating activities, i.e., either its principal or ancillary revenue-generating activities but which is not a revenue arising from sale of products or rendering of services. Further, interest income in the case of a company other than a finance company needs to be disclosed under the head 'other income'.

EAC assessed that Company's operating activities comprises activities relating to execution of project and during project execution, excess funds are deployed with banks leading to earning of interest income. EAC pointed out that accounting treatment depends on the nature of income and mere allowing to retain or use interest income for meeting the operational expenditure does not change the nature of income. The EAC was also of the view that regularity or quantum of an item of income may not necessarily determine the nature of an income as operating or non-operating. EAC further noted that facts provided by the company do not clearly demonstrate that MOR allowed the Company to temporarily park such funds and whether interest income earned on such parked funds is Income for Company or not. Therefore, considering the facts of the extant case, EAC opined that interest income should be disclosed under the head 'other income' and presentation followed by Company is not in line with the requirement of Guidance Note issued by ICAI.

EAC-3 Adoption of 'Net Book Value' method as one of the valuation techniques to measure the fair value of investments in equity instruments that do not have a quoted market price in an active market

Background

A Government company is in the business of providing technology solution to strategic users in Defense, atomic energy and similar others. The Company has investment in A Corporation Ltd which is not a subsidiary, associate or join venture. As per transition option mentioned in para D19B of Ind AS 101, the Company has opted to designate such equity investment at Fair Value Through Other Comprehensive Income (FVTOCI) in accordance with Ind AS 109 basis the facts and circumstances existed as on the transition date. A Corporation Ltd. is not a listed entity and hence does not have a quoted market price in an active market. The investment is measured at FVTOCI using the Net Book Value (NBV) Method on account of non-availability of quoted price in the active market.

C&AG contended that investment in equity shares should have been measured at cost since A Corporation Ltd is not traded in the active market.

The opinion of EAC is sought as to whether the adoption of the NBV method by the Company as one of the valuation techniques to measure the fair value of equity investments in A Corporation Ltd. is in order or it should be measured at cost.

EAC view

EAC noted that as per Ind AS 109, all investments in equity instruments are to be measured at fair value irrespective of whether these are quoted or not quoted in an active market except in limited circumstances, where cost may be an appropriate estimate of fair value. That may be the case if insufficient more recent information is available to measure fair value, or if there is a wide range of possible fair value measurements and cost represents the best estimate of fair value within that range.

EAC further noted that as per the requirements of Ind AS 109, fair value has to be determined as per the requirements of Ind AS 113 - Fair Value Measurements. With regard to the method of valuation as per Ind AS 113, the Company should determine the fair value considering its specific facts and circumstances using valuation technique(s) and using one or more observable and unobservable inputs in such cases.

EAC opined that while determining fair value of equity investment, NBV of net assets could be used as the beginning point or as one of the inputs, which may require further adjustments as per the valuation technique(s) considering the requirement of Ind AS 113, but the book value itself cannot be directly considered as a substitute of fair value. Accordingly, the Company has not correctly followed the approach, technique and methodology prescribed under Ind AS 113 to determine the fair value of its equity investment in A Corporation Ltd.

EAC-4 Accounting treatment of perpetual lease in the books of Lessee

Background

A Company is engaged in the business of refining and marketing of petroleum products, petrochemicals, gas and alternate energy. The Company has taken land on a perpetual lease with one-time upfront premium on commencement date and rent is payable on a periodic basis. There are restrictions on the use of land like:

(i) Land is restricted to office use only,

(ii) Agreement gives blanket right to the lessor to remove any building paying only compensation,

(iii) Lessor can increase rent at its own discretion,

(iv) The Company needs the permission of lessor for alteration in layout, etc.

According to the querist, since perpetual lease is not covered in the exclusions given in Ind AS 116 above, leases of perpetual nature are also covered within the ambit of Ind AS 116.

Accordingly, the Company has recorded lease liability at the present value of lease payments using the Company's borrowing rate and no unwinding is done. The right of use (ROU) asset is measured and recognized at the amount equal to lease liability plus one time amount paid, and the same is not amortized. As all the liability toward lease till perpetuity has already been provided by the Company, payment of fixed rent by the Company is being booked as finance cost in the financial statements.

C&AG is of the view that in the perpetual lease cases, there is no defined period and thus is effectively a form of ownership interest. Further, Ind AS 116 requires lease term to be assessed if the contract is lease contract. Considering these facts, C&AG contended that these perpetual leases of land should have been recognized as freehold land under PPE on historical cost basis instead of ROU as per Ind AS 116.

EAC opinion has been sought on whether the accounting treatment followed by an entity for accounting of perpetual lease of land is correct.

EAC view

EAC noted that in the case of long-term leases, an important aspect to be examined is whether the contract transfers control of the underlying asset or only right to control the use of the asset. For an entity to control the underlying asset, the future economic benefits from that asset must flow to the entity either directly or indirectly.

In extant case, EAC evaluated that if the Company wants to sell, transfer or assign the possession of the land, prior consent of the lessor is required, and lessor may impose terms and conditions on the usage of asset. EAC opined that land cannot be recognized as PPE since the future economic benefits from the land will not entirely flow to the Company in the current case. Hence, the arrangement is in substance a lease transaction and recognition and measurement principles of Ind AS 116 should be applied. Therefore, a right-of-use asset, lease liability and finance cost should be recognized as per the requirements of Ind AS 116. Further, EAC emphasized that land has an unlimited useful life, and the lease team is also perpetual. Thus, Company should apply requirements of Ind AS 36 – Impairment of Assets to determine if the asset is impaired.

EAC-5 Accounting treatment of delayed payment charges

Background

The Company is engaged in the business of distribution of power to the consumers. The Company collects delayed payment charges (DPC) in case of late payment against outstanding energy bills. The DPC are recognized as revenue from operations under the heading of 'Income from other operating activity' and the same is presented as 'Cash Flows from Operating Activities' in the Statement of Cash Flows

However, C&AG has contended that the delayed payment charges should be presented as 'Other Income' and should be presented as 'cash flows from investing activities' in the Statement of Cash Flows'.

EAC opinion has been sought on treatment of delayed payment charges in the Statement of Profit and Loss and in Statement of Cash Flow.

EAC view

EAC noted that the Tariff Schedule provides terms for late payment from the due date of payment, which is binding on both the buyer as well as the Company. The EAC further noted that delayed payment charges are charges to the customers who have not paid the bill within due date as per Tariff Schedule and that such charges are defined in terms of percentage per annum, which indicates that the same is directly linked with the passage of time and the quantum of the same depends on timing of payment by the customers. Thus, the amount of consideration varies due to the difference in timing of payments (as the consideration will increase with the increase in timing of payment).

Accordingly, DPC are charges to the customers who have not paid the bill within due date and not toward exchange of promised goods and services. DPC is a levy on customers for default on their part and therefore, it cannot be considered in the nature of penalty covered under variable consideration as per the requirements of Ind AS 115.

Further, EAC noted that DPC is of the nature of financing component defined in percentage, which indicates that the same is directly linked with the passage of time. EAC opined that if such component is significant and the practical expedient is either not applied or not applicable as per the requirements of Ind AS 115, the Company should not consider the same as part of revenue from operation and should present the same as 'other income' in the statement of profit and loss. Further, EAC opined that treatment in the Statement of Cash Flows should be in line with the classification and presentation in the Statement of P&L.

EAC- 6 Valuation of inventory of non-valuated by-products

Background

A Company is engaged in the manufacture of the steel products. In the process of steel making, the Company is generating certain by-products which are immaterial in value as compared to value of main product. The inventory of these by-products was valued at nil because the Net realizable value (NRV) for these by-products was nil on its origination. However, due to the advancement in the technology/ market, the scope for saleability/ usability of these inventory increased substantially and by products are expected to fetch certain values in the current period. Hence, the Company desires to value these immaterial by-products at current NRV.

The opinion of the EAC has been sought on whether the by-products can be valued at current NRV and if yes, whether the accounting treatment due to the proposed change in valuation is considered as a change in accounting estimate or change in accounting policy as per Ind AS 8.

EAC view

EAC noted that when by-products are produced simultaneously with the main product, the cost of conversion till that stage is assigned to/allocated between them on a rational and consistent basis, for example, on the basis of relative sales value of each product, so as to arrive at their respective costs till the stage of separation, which becomes the basis for their valuation in the further stages. However, the immaterial by-products are often measured at NRV and the same is deducted from the cost of the main product and as a result of which, the carrying amount of the main product is not materially different from its cost.

The EAC is of the view that the objective of principle laid in paragraph 14 of Ind AS 2 is to allocate production/ conversion costs on a reasonable basis to determine the cost of production/ conversion of each individual product being produced simultaneously in the production process which is not materially different from the actual cost. Thus, the costs so arrived at becomes the substitute for the cost for valuation of inventories subsequently. Subsequently, while measuring the inventories at the lower of cost and NRV as per the principles of Ind AS 2, such cost should be considered

EAC is of the view that the cost of by-product arrived at on the basis of NRV at the time of their origination or separation from the main product becomes the substitute of cost for subsequent valuation of inventories. Therefore, in spite of the increase in NRV of by-products, their value for accounting cannot be increased since as per the principles of Ind AS 2, these need to be valued at lower of cost (which is nil in the extant case) and NRV.

EAC further opined that any change in NRV of the inventory of the by-product is the result of changes in technological advancements and new developments, and not due to initial application of any new Standard or accounting requirements. Therefore, these should be considered and accounted for as changes in accounting estimates as per the requirements of Ind AS 8. However, since cost of these accumulated inventories of by-products has been considered at nil considering nil net realizable value earlier, in spite of the increase in NRV of by-products, their value for accounting cannot be increased as per the principles of Ind AS 2.

EAC-7 Classification of an entity as subsidiary or joint venture and consolidation thereof

Background

A State Government Company ("Company) has entered into a Joint Venture (JV) agreement with a private company, A Ltd. to form a Joint Venture Company (JVC) in which the Company shall be holding 51% equity shares. As per the JV Agreement, A Ltd. should make all the investments and the Company shall have no financial liability with respect to the JVC.

As per the terms and conditions of the JV Agreement, the Company should obtain a mining lease of the lignite mines in reference from the State Government and transfer the same to the JVC. The Company should also obtain all necessary licenses/consents/ approvals from the Government and regulatory approvals/consents from the Central as well as the State Government for use, operation, development and management of the mines. As per the terms of the Agreement, JVC/A Ltd. shall bear all the expenses incurred / to be incurred by the Company. After transfer of mining leases in favor of JVC, the lignite mines would be developed and operated by JVC/A Ltd. and the lignite to be mined from the mines is to be consumed by the private company for power generation by lignite-based power plant to be established by A Ltd.

In this regard, important clauses of the Joint Venture Agreement entered between A Ltd. and the Company are as under:

- Board composition of JVC would be a total of seven directors of which four directors would be nominated by the Company and three directors would A Ltd.'s nominee.
- The day-to-day management of the JVC shall be delegated to a Managing Director (MD), nominated by A Ltd. No amendment or reduction of powers shall be valid without the prior unanimous consent of A Ltd. and the Company.
- No business at any meeting including adjourned meetings of the Board shall be transacted unless at least one Director of A Ltd. and One Company's Director are present at commencement of such meeting and throughout its proceedings.
- Voting at Board Meetings shall require approval of at least one Director of A Ltd. and One Company's Director.
- No resolution shall be deemed to have been duly passed by the Board or a Committee thereof by circulation unless the resolution has been circulated in draft, together with the necessary papers, if any to all directors or to all members of the committee, and to all other directors or members at their usual address, and has been approved by a majority of such of them as are entitled to vote on the resolution having one Director of A Ltd. and one Company's Director.

Company had assessed the investment in JVC as subsidiary based on its 51% shareholding and board composition (four out of seven are nominated by Company and also the MD has a casting vote). Therefore, consolidation of JVC was accounted on a line-by-line basis.

The C&AG contended that the determination of a subsidiary is to be made on the basis of 'control' defined in Ind AS 110, and not merely on the basis of shareholding.

The querist has sought the opinion of the EAC regarding the method to be followed for consolidation of the financial statements of A Ltd.

EAC view

EAC noted that in extant case, without the approval or consent of one of the Directors of A Ltd., no decision can be taken at the meetings of the Board. Further, although the Chairman of the Board, who shall be either nominated by the State Government or the Company (in the absence of Chairman nominated by the state Government is absent at the meeting) has a casting vote at the board meeting, since decision of the Board require approval of at least one of the Director of A Ltd., the decisions about relevant activities cannot be taken unilaterally by the Company. Moreover, even at the General Meetings of the JVC, although all resolutions shall be carried by a majority vote, the affirmative vote of A Ltd. and the Company as shareholder is required, which further corroborates the fact the decisions about the activities of the JV company cannot be taken by the Company unilaterally. The EAC also noted that although the Managing Director would exercise its powers under the overall control of the Board where Company has majority, however, the scope of powers of MD nominated by A Ltd. cannot be changed or reduced without the approval of A Ltd

Accordingly, considering the requirements of Ind AS 110 and Ind AS 111, EAC opined that, in spite of the majority shareholding, the Company will not be able to take the decisions about the relevant activities of the JVC unilaterally, rather the decisions are taken unanimously by both Company and A Ltd.

Hence, EAC opined that, in extant case, JVC is not a subsidiary of the Company but it is a joint arrangement. Therefore, the Company should not do line by line consolidation of the financial statements of the JVC but should account for the joint arrangement under the requirement of Ind AS 111.

EAC-8 Non-reversal of impairment in respect of investment in subsidiary in separate financial statements on account of non-reversal of impairment in underlying goodwill

Background

A Company is engaged in the business of exploration and production of oil and gas and has acquired 60% shares in an overseas company (subsidiary company X). In SFS of the Company, the purchase consideration paid for acquiring 60% stake is recognized as an investment in the subsidiary. In CFS of Company, goodwill is recognized on the acquisition date since the consideration paid was higher than the net assets acquired of subsidiary company X.

Subsequently, on impairment assessment, an impairment loss is estimated as per Ind AS 36. The said impairment loss was charged against the associated goodwill in CFS. In the SFS, an equivalent impairment loss was provided against the carrying value of the investment in subsidiary X considering a permanent decline in the value of underlying assets represented by an impairment loss charged against goodwill.

In subsequent years, impairment reversal was required being the higher recoverable value than the carrying value in both CFS and SFS. Company contended that reversal of impairment loss is not permitted as per Ind AS 36 since the impairment loss was charged against the goodwill in CFS. Basis the fact that carrying value in SFS also represents the goodwill component, reversal of impairment provision was not done in SFS as well.

C&AG raised a query on the company's assessment of non-reversal of impairment provision in SFS.

EAC opinion has been sought on whether the approach adopted by Company for not reversing the impairment loss in SFS is appropriate in light of provisions of Ind AS 36. If no, whether reversal impact is required to be given retrospectively or prospectively in SFS.

EAC view

EAC noted that criteria and methodology of impairment assessment in SFS and CFS is different. In the case of SFS, the recoverable amount of an investment in a subsidiary would normally be based on the value in use or fair value less costs of disposal based on the parent's share of estimated cash flows from the investment in subsidiary. On the other hand, the net assets of the subsidiary are presented in CFS and there may be different Cash Generating Unit (CGU) at the CFS level considering the requirements of Ind AS 36. Thus, the CGU at CFS level being different from the CGU at the SFS level, there may be differences in the recoverable amount at CFS and at SFS level. There could be further possible differences in the recoverable amount at CFS and at SFS level due to factors, such as, the level at which CGU is determined, impact of intra-group transactions, business synergies arising outside the subsidiary and the first-time adoption exemption for business combination availed by the group.

The EAC emphasized that the exception of Ind AS 36 prohibits recognition of reversal of impairment loss applies only to goodwill and not to any other assets and para 4 of Ind AS 36 specifically covers investments in subsidiary in the SFS within its scope. Basis the careful evaluation of facts in the extant case, EAC opined that, practice followed by Company in SFS is not in line with requirements of Ind AS 36. Further, EAC is of the view that the treatment followed in SFS constitutes an error as per Ind AS 8 and therefore Company should rectify the accounting treatment as prior period error retrospectively in the first set of SFS issued after discovery of error.

EAC-9 Accounting treatment in the Company's standalone financial statements for the Corporate Guarantee issued by the Company being Parent Company to banks/ suppliers/service providers on behalf of its step-down subsidiary company

Background

A Company is in the business of procuring, transmission, processing and marketing of natural gas. The Company has a wholly owned subsidiary in the USA (subsidiary 1) and a Step-down subsidiary engaged in LNG trading business.

Step down subsidiary has entered into the contract with suppliers to purchase the natural gas. The Company and step- down subsidiary have entered into LNG Sale & Purchase Agreement (SPA), wherein the step-down subsidiary is to sell the entire quantity of LNG to the Company on back-to-back basis. The step-down subsidiary bears limited risk and is acting as a low margin distributor and managing the operations of the contracts only.

The Company has issued corporate guarantees on behalf of its step-down subsidiary to the suppliers and to the bank for obtaining working capital loan. The bank loans are availed by step-down subsidiary to meet the temporary obligations to the suppliers since there may be time lag between payment made by the Company to step-down subsidiary for making the further payment to suppliers.

Based on the structure of the contracts, the step-down subsidiary can make timely payments to suppliers only if it receives timely payments from the Company. Company contended that since payment to third parties is solely within the control of Company, no guarantee fee has been charged from the step-down subsidiary and also Expected Credit Loss (ECL) has not been recognized on the corporate guarantee contract.

EAC opinion has been sought on accounting treatment to be followed in separate financial statement of a company for corporate guarantees issued to step-down subsidiary and its corresponding implication ECL on recognition and disclosures.

EAC view

The EAC noted that the contingent right of the suppliers to receive payment and contingent obligation of Company to make payment in case step-down subsidiary fails to make payment meets the definition of financial guarantee contract under paragraph AG8 of Ind AS 32. EAC believes that it should be accounted in accordance with Ind AS 109, notwithstanding the fact that a step-down subsidiary's financial performance and position may be dependent on the business that it generated with the Company, and the Company is the ultimate beneficiary of the step-down subsidiary's operation. Accordingly, in the extant case Company should initially recognize a liability (such as unearned financial guarantee commission) at fair value in its separate financial statements. The EAC further notes guarantee obligation has been undertaken by the Company in its capacity as the ultimate parent and it has a right to future economic benefits arising from its overall investments in the step-down subsidiary through its control over Subsidiary 1. Therefore, upon initial recognition of the financial guarantee liability, the Company should recognize deemed investment in the Subsidiary 1 as per the requirement of Ind AS 27.

EAC further noted that the trade payable for the goods purchased from the step-down subsidiary and the financial guarantee issued Company to third party on behalf of the step-down subsidiary are separate financial liabilities emanating from separate transactions. Therefore, EAC was of the view that recognizing the two financial liabilities and providing for loss allowance on the financial guarantee contract would not result in duplication or overstating of liabilities. In the extant case, even though failure to pay third parties is solely within the control of Company but there could be a time lag in payment made by Company to step-down subsidiary and payment made by the step-down subsidiary to its suppliers, which could result in recognition of ECL at the reporting date for some time till the payment becomes due from the Parent company from the perspective of the step-down subsidiary

Further, the financial guarantee contracts are governed by Ind AS 109 and cannot be classified as contingent liabilities as per Ind AS 37. Hence, in this case company should comply disclosure requirements of Ind AS 107 and Division II of Schedule III to the Companies Act, 2013.

EAC-10 Presentation of advance given under Current Assets - other current assets

Background

A Company had entered into a contract with a supplier in the year 1995-96 for supply of goods and made advance payment for the same. The shipment of material supplied was found to be below specification and was not accepted resulted into termination of contract. The matter regarding remittance of the advance payment and non-supply of material is under litigation

The advance paid to supplier was presented under Current Asset – Other Current Assets in the Balance Sheet and corresponding provision for doubtful advance is recognized for full amount of advance. It may be noted that in Note 18, the advance to A Ltd. of Rs. 129.64 crore has been fully provided as doubtful advances; hence the amount paid as advance to A Ltd. appearing in the Note - Other Current Assets is Nil.

Auditor of Company raised a query for presenting the advances as current asset even though due more than 25 years.

EAC opinion has been sought on presentation of advances under litigation as current or non-current and also on its measurement under the requirement of Ind AS 113.

EAC view

EAC has opined that the presentation of advance given as current or non-current depends on expectations of realizability within twelve months from the reporting period as per the requirement of Ind AS 1. The Company should classify the advance as current only to the extent it is expected to be realized within the next twelve months after the reporting period taking into consideration various factors, such as, expectation of the outcome of litigation, opinions/views of legal experts, the experience of the enterprise in similar cases, etc.

Further, EAC is of the view that since recovery against the advance has not been made by the Company even after 25 years and the fact that the Company has provided for the provision against its doubtful recovery in full, which has not been reversed at the current reporting date strongly indicates that the amount of advance is not realizable in entirety within the next twelve months after the reporting period. Accordingly, the Company should classify the advance as current asset only to the extent it is expected to be realized within the next twelve months after the reporting period taking into consideration various factors as stated above and the balance amount should be classified as non-current asset. EAC opined that in case the Company has the right to receive cash as per the terms of contract, the Company should recognize it as a financial asset and classify and measure the same at fair value depending on classification and other applicable requirements of Ind AS 109, 'Financial Instruments. Further, the presentation and disclosure requirements of Division II of Schedule III to the Companies Act, 2013 should also be followed.

EAC-11 Capitalization of insurance premium in construction projects

Background

A Company constructs Hydropower Projects and operates them on a build, own, operate and maintain basis.

To mitigate the loss of property and lives due to any unforeseen event, insurance cover by way of Engineering All Risk (EAR) and Contractors All Risk (CAR) insurance policies are obtained. Other than the CAR/EAR Policy, other insurance policies obtained are for insurance of construction equipment, vehicles and other miscellaneous assets. Insurance coverage of projects under construction is a pre-condition for obtaining project-based funding and not obtaining the same shall have an adverse impact on the credit-rating of the Company which shall consequently have an adverse effect on the rate at which the Company is able to access finance for project construction.

Execution of the project is done through contractors. It is the responsibility of the contractor to obtain the EAR/CAR Policy. Accordingly, the cost of obtaining such policy is inbuilt by the contractor in the bid-price for the work. In case the contractor is unable to obtain such a policy, the same is obtained by the Company and premium, so paid is recovered from the on-account payments made to the Contractor.

Tariff fixed by the Central Electricity Regulatory Commission (CERC) for each power station is based on the capital cost incurred for the power station. Before the start of active construction of a hydro power project, certain approvals from various Government Ministries and agencies are required to be obtained including the final investment approval being that of the Cabinet Committee on Economic Affairs (CCEA). The Guidelines issued by the Central Water Commission (CWC) are the basis for framing the cost estimate of any hydro power project and it provides for inclusion of Construction

Insurance in Project cost. Considering the above facts, the Company capitalizes the premium paid for obtaining the CAR/EAR policies along with the cost of the project.

C&AG has raised the query that insurance premium paid for obtaining the CAR/EAR policy is of revenue nature and accordingly, should not be capitalized.

EAC opinion has been sought as to whether the premium paid for insurance coverage of assets under construction and other PPE of a hydro-electric project under construction qualifies for capitalization.

EAC view

EAC noted that the expenses that are directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management should only be capitalized as per the requirement of Ind AS 16.

The EAC noted that in the extant case, to mitigate the loss of property and lives due to any natural disaster like floods, earthquake, landslides and non-natural events like terrorism, during the construction stage, the Company has obtained insurance cover by way of EAR and CAR insurance policies.

EAC is of the view that from the facts of the case that the insurance premium has been included as a part of the approved or allowable expenditure under various approvals (including that from CCEA and CWC) and is an inbuilt element of the project cost and not an optional expenditure. From this, it appears that the incurrence of insurance expense is essential or a pre-condition for obtaining such approvals, without which construction activity cannot be commenced and the project cannot be brought to the location and condition necessary for it to be capable of operating in the manner intended by management and therefore, EAC opined that the insurance premium should be capitalized with the cost of an item of PPE.

3. IFRS Interpretations Committee Discussion (IFRS IC)

IFRIC Agenda Decision Paper:

1. Demand Deposits with restrictions on use arising from a contract with a third party – April 2022

Background

The entity holds a demand deposit whose terms and conditions do not prevent the entity from accessing the amounts held in it and entity has a contractual obligation with a third party to keep a specified amount of cash in that separate demand deposit and to use the cash only for specified purposes. If the entity were to use the amounts held in the demand deposit for purposes other than those agreed with the third party, the entity would be in breach of its contractual obligation.

Issue

Whether an entity includes a demand deposit as a component of cash and cash equivalents in its statements of cash flows and financial position when the demand deposit is subject to contractual restrictions on use agreed with a third party.

Discussion

The IFRS IC noted that the question in the request is about whether the demand deposit meets the definition of 'cash' in IAS 7.

Paragraph 6 of IAS 7 defines 'cash' by stating that it 'comprises cash on hand and demand deposits.' IAS 7 includes no requirements for whether an item qualifies as cash beyond the definition itself.

The restrictions on the use of the demand deposit arising from a contract with a third party do not change the nature of the deposit as the entity can still access those amounts on demand. Thus, the IFRS IC concluded that the demand deposit shall be included as a component of 'cash and cash equivalents' in its statement of financial position and statement of cash flows as it still meets the definition of cash in IAS 7. Also in accordance with Para 55 of IAS 1 an entity would disaggregate the cash and cash equivalents line item and present the demand deposit separately in an additional line item.

The entities shall also take into consideration Para 48 of IAS 7 which requires an entity to disclose information about 'significant cash and cash equivalent balances held by the entity that are not available for use by the group' and Paragraph 66(d) of IAS 1 which requires an entity to classify as current an asset that is 'cash or a cash equivalent unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.

Conclusion

The IFRS IC concluded that the principles and requirements in IFRS accounting standards provide an adequate basis for an entity to determine whether to include demand deposits subject to contractual restrictions on use agreed with a third party as a component of cash and cash equivalents in its statements of cash flows and financial position.

2. Revenue from Contracts with Customers - Principal versus Agent: Software Reseller – April 2022

Background

The reseller has entered into a distribution agreement with the software manufacturer to undertake the following:

a) Granted the right to sell the standard software license to third party customer at a price negotiated by the reseller

b) Requires the reseller to provide pre-sale advice to determine the correct license version and the quantum of licenses that would be required as per customer demand

c) Reseller to place an order with the software manufacturer on behalf of the customer, if it decides to buy the software license (i.e., determines type and number)

The software manufacturer provides the customer with the software licenses ordered — issued in the customer's name — via a software portal and with the key necessary for activation. It has an obligation to provide the access and the activation key to the software license basis and enter into 'right to use' agreement with the customer, which also covers the warranty of the software functionality for the term of license.

If the reseller advises the customer to order an incorrect type or number of software licenses (that fails to meet the customer's needs), the customer may not accept the licenses. The reseller is unable to return unaccepted licenses to the software manufacturer or sell them to another customer

Issue

Whether a software-resellers is a principal or an agent as per the principles of IFRS 15?

Discussion:

IFRS 15 paragraph B34-38 sets a framework to evaluate whether an entity is a principal or an agent. When another party is involved in providing goods or services to a customer, an entity determines whether the nature of its promise is a performance obligation to provide the specified goods or services itself as a principal or to arrange for those goods or services to be provided by the other party as an agent.

An entity is a principal if it controls the specified good or service before that good or service is transferred to a customer (paragraph B35). An entity that is an agent does not control the specified good or service provided by another party before that good or service is transferred to the customer (paragraph B36).

The IFRS IC observed that, the key evaluation of the software-reseller arrangement is undertaken as follows:

a) Identified goods or services provided to the customer are distinct

(i) The pre-sales advice the reseller provides — under the distribution agreement between the software manufacturer and the reseller — is not an implicit promise in the contract with the customer. At the time of entering into the contract with the customer, the reseller has already provided the advice. Consequently, at the time of entering into the contract with the customer, the customer has no valid expectation that the reseller will transfer a good or service other than the standard software licenses.

(ii) The promised goods in the reseller's contract with the customer are the standard software licenses which are distinct goods to be provided to the customer. Those licenses are therefore the only specified goods to be provided to the customer.

b) Assess whether the reseller controls the specified goods or services transferred to the customer

(i) The software manufacturer is responsible for the software's functionality, as well as for issuing and activating the licenses and is therefore, responsible in those respects for fulfilling the promise to provide the identified goods (i.e., the licenses) to the customer.

(ii) The reseller engages with the customer before and after the service and is responsible for delivery to the customer taking responsibility for unaccepted licensees. The reseller is, therefore, responsible in those respects for fulfilling the promise to provide the licensees to the customer

(iii) The reseller does not obtain a pool of software licenses before entering into the contract with the customer and as such, the reseller has no inventory risk before the licenses are provided to the customer, but then has inventory risk until the customer accepts the licenses.

(iv) The reseller also has a discretion in setting / negotiating the price with the customer. Pricing discretion may be less relevant to the assessment of control if, for example, the market for the software licenses is such that the reseller, in effect, has limited flexibility in establishing the price.

Conclusion:

The Committee observed that, the reseller would apply judgement in making its overall assessment of whether it is a principal or agent— including considering the relevance of the indicators to the assessment of control and the degree to which they provide evidence of control of the standard software licenses before they are transferred to the customer basis the specific facts and circumstances, including the terms and conditions of the relevant contracts.

3. Negative Low Emission Vehicle Credits – July 2022

Background

The IFRS IC received a request asking whether particular measures to encourage reductions in vehicle carbon emissions give rise to obligations that meet the definition of a liability in IAS 37.

The request described government measures that apply to entities that produce or import passenger vehicles for sale in a specified market. Under the measures, entities receive positive credits if, in a calendar year, they have produced or imported vehicles whose average fuel emissions are lower than a government target and receive negative credits in a vice versa situation.

Negative credits can be eliminated only by generating positive credits which the entity can either obtain by purchasing them from another entity or by generating them itself in the next year (by producing or importing more low-emission vehicles). If the entity fails to eliminate its negative credits, the government can impose sanctions on the entity. These sanctions would not require payment of fines or penalties, or any other outflow of resources embodying economic benefits, but could deny the entity future opportunities, for example, by restricting the entity's access to the market.

Issue

Whether the entity, which has negative credits in a year, has a present obligation that meets the definition of a liability in IAS 37.

Discussion

The IFRS IC noted that in determining whether it has a liability, the entity would consider following :

a) *Whether settling an obligation to eliminate negative credits would result in an outflow of resources embodying economic benefits*
An entity can settle an obligation to eliminate negative credits either by purchasing credits or by generating positive credits. IFRS IC discussed that either case would result in an outflow of resources embodying economic benefits, the resources being the positive credits. Even if the obligation is settled by generating positive credits, the same could have been used for other purposes, for example, by selling it to other entities with negative credits

b) *The event that creates a present obligation*
IFRS IC noted that the activity that triggers a requirement to eliminate negative credits is the production or import of vehicles with average fuel emissions higher than government targets. Hence, it is an present obligation that has arisen from a past event and exists independent of its future actions, as the future action will determine only the means by which the present obligation will be settled.

c) *No realistic alternative to settling an obligation*
The IFRS IC discussed that an entity would have a legal obligation that is enforceable by law if accepting the possible sanctions for non-settlement is not a realistic alternative for that entity. The IFRS IC observed that determining whether accepting sanctions is a realistic alternative for an entity requires judgement. The conclusion will depend on the nature of the sanctions and the entity's specific circumstances.

d) *The possibility of a constructive obligation*
The IFRS IC concluded that, if an entity determines that it has no legal obligation to eliminate its negative credits, it will then need to consider whether it has a constructive obligation to do so. It will have a constructive obligation if it has negative credits in a year and has taken an action that creates valid expectations in other parties that it will eliminate the resulting negative credits—for example, made a sufficiently specific current statement that it will do so.

Conclusion

The IFRS IC concluded that the principles and requirements of IFRS accounting standards provide an adequate basis for an entity to determine whether, in the fact pattern described in the request, it has an obligation that meets the definition of a liability in IAS 37.

4. Lessor Forgiveness of Lease Payments –October 2022

Background

Rent concession is agreed by a lessor and a lessee, where in the original terms and conditions of a lease contract is classified by the lessor as operating lease in accordance with IFRS 16. The lessor legally releases the lessee from its obligation to make specifically identified lease payments, some of which are contractually due but not paid, while some of them are contractually not due.

Issue

The concerns raised were:

a) How the lessor applies the Expected Credit Loss model (ECL) in IFRS 9 to the operating lease receivable before the rent concession is granted if it expects to forgive payments due from lessee and

b) Whether the lease applies the derecognition requirements in IFRS 9 or the lease modification requirements in IFRS 16 in accounting for rent concession

Discussion

a) How the lessor applies the Expected Credit Loss model (ECL) in IFRS 9 to the operating lease receivable before the rent concession is granted if it expects to forgive payments due from lessee

IFRS 9 states that operating lease receivables recognized by a lessor are subject to the derecognition and impairment requirements in IFRS 9. Therefore, a lessor is required to apply the impairment requirements in IFRS 9 to the gross carrying amount of an operating lease receivable from the date on which it recognizes that receivable, considering applicable derecognition requirements in IFRS 9.IFRS 9 defines credit loss as the difference between all contractual cash flows that are due to an entity in accordance with the contract and all the cash flows that the entity expects to receive. Also, IFRS 9 states that an entity shall measure credit loss in a way that it reflects an unbiased and probability weighted amount that is determined by evaluating a range of possible outcomes, time value of money and reasonable and supportable information that is available without undue cost or effort. Hence the committee concluded that, before the rent concession is granted, lessor should measure ECL which should reflect unbiased and probability weighted amount, time value of money, reasonable and supportable information and lessor's expectation of forgiving lease payments.

b) Whether the lease applies the derecognition requirements in IFRS 9 or the lease modification requirements in IFRS 16 in accounting for rent concession

For the second concern raised, it was discussed that the derecognition requirements of IFRS 9 applies to forgiven lease payments recognized as an operating lease receivable and the lessor remeasures the expected credit losses on the operating lease receivable and derecognizes the operating lease receivable owing to the fact that it legally releases the lessee from its obligation to make specifically identified lease payments.

The lease modification requirements in IFRS 16 are not applicable to operating lease receivable already recognized by lessor as they are not "accrued lease payments" which are needed to be considered as part of the lease payments for the new lease, in accordance with Para 87 of IFRS 16. Hence the lease modification requirements in IFRS 16 are applicable to forgiven lease payments that are not recognized as operating lease receivable in the books of lessor.

Conclusion

The IFRS IC concluded that the principles and requirements of IFRS accounting standards provide an adequate basis for a lessor to determine how to apply the expected credit loss model in IFRS 9 to an operating lease receivable and account for the rent concession described in the request.

5. Special Purpose Acquisition Companies (SPAC): Accounting for Warrants at Acquisition - October 2022

Background

(i) The entity acquires a SPAC that has raised cash in an initial public offering (IPO), obtaining control of the SPAC. The purpose of the acquisition is for the entity to obtain the cash and the SPAC's listing on a stock exchange. The SPAC does not meet the definition of a business in IFRS 3 and, at the time of the acquisition, has no assets other than cash

(ii) Before the acquisition, the SPAC's ordinary shares are held by its founder shareholders and public investors which are deemed to be equity instruments as defined in IAS 32. In addition, SPAC had also issued warrants to both its founder shareholders (as consideration for services the founders provided) and public investors (the SPAC warrants)

(iii) The entity issues new ordinary shares and new warrants to the SPAC's founder shareholders and public investors in exchange for the SPAC's ordinary shares and the legal cancellation of the SPAC warrants

(iv) The SPAC becomes a wholly owned subsidiary of the entity and the entity replaces the SPAC as the entity listed on the stock exchange

(v) The SPAC's founder shareholders and public investors are not SPAC employees nor will they provide services to the entity after the acquisition

(vi) The fair value of the instruments the entity issues to acquire the SPAC exceeds the fair value of the SPAC's identifiable net asset

In a SPAC transaction, when the target is identified as the accounting acquirer and the SPAC (as the legal acquirer) does not constitute a business, the target is deemed to have issued shares to obtain control of the SPAC and the acquisition of the listed status of the SPAC is accounted for as a share-based payment transaction under IFRS 2 Share-based Payment.

Adarsh Ranka

Financial Accounting Advisory Services Leader, Partner with an Indian member firm of EY Global

Issue

Which IFRS Accounting Standard applies to the SPAC acquisition and how are they considered for accounting?

Does the entity also acquire a stock exchange listing service?

Discussion

Which IFRS Accounting Standard applies to the SPAC acquisition and how are they considered for accounting?

Paragraph 2(b) of IFRS 3 states that IFRS 3 does not apply to 'the acquisition of an asset or a group of assets that does not constitute a business.'

The acquisition of the SPAC is the acquisition of an asset or a group of assets that does not constitute a business. Therefore, the entity identifies and recognizes the individual identifiable assets acquired and liabilities assumed as part of the acquisition.

In the fact pattern discussed, the entity acquires the cash held by the SPAC. The entity also considers whether it assumes the SPAC warrants as part of the acquisition and, consequently, whether it assumes a liability if those warrants are classified as financial liabilities.

In assessing whether it assumes the SPAC warrants as part of the acquisition, the entity considers the specific facts and circumstances of the transaction, including the terms and conditions of all agreements associated with the acquisition. For example, the entity considers the legal structure of the transaction and the terms and conditions of the SPAC warrants and the new warrants the entity issues.

The entity might conclude that the facts and circumstances are such that it:

- assumes the SPAC warrants as part of the acquisition—in this case, the entity issues ordinary shares to acquire the SPAC and assumes the SPAC warrants as part of the acquisition. The entity then issues new warrants to replace the SPAC warrants it has assumed.
- does not assume the SPAC warrants as part of the acquisition—in this case, the entity issues both ordinary shares and new warrants to acquire the SPAC and does not assume the SPAC warrants.

Additional considerations are applicable when an entity concludes that it assumes the SPAC warrants as part of the acquisition

How does the entity account for SPAC warrants assumed as part of the acquisition?

In the fact pattern discussed, the SPAC's founder shareholders and public investors are not SPAC employees, nor will they provide services to the entity after the acquisition. Instead, the SPAC's founder shareholders and public investors hold the SPAC warrants solely in their capacity as owners of the SPAC. Therefore, the entity applies IAS 32 to determine whether the SPAC warrants are financial liabilities or equity instruments.

How does the entity account for the replacement of the SPAC warrants?

The entity applies IAS 32 and IFRS 9 Financial Instruments to account for the replacement of the SPAC warrants with new warrants.

However, because the entity negotiated the replacement of the SPAC warrants as part of the SPAC acquisition, it determines whether it accounts for any of the new warrants it issues as part of that acquisition. No IFRS Accounting Standard specifically applies to making this determination. Therefore, the entity applies paragraphs 10–11 of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors in developing and applying an accounting policy that results in information that is relevant and reliable.

Does the entity also acquire a stock exchange listing service?

The SPAC's stock exchange listing does not meet the definition of an intangible asset because it is not 'identifiable' as described in paragraph 12 of IAS 38 Intangible Assets. Accordingly, the stock exchange listing is not an identifiable asset acquired.

Nonetheless, the IFRS IC observed that, paragraph 2 of IFRS 2 states that 'an entity shall apply this IFRS in accounting for all share-based payment transactions, whether the entity can identify specifically some or all of the goods or services received. In the absence of specifically identifiable goods or services, other circumstances may indicate that goods or services have been (or will be) received, IFRS 2 applies. Paragraph 13A of IFRS 2 states that if the identifiable consideration received (if any) by the entity appears to be less than the fair value of the equity instruments granted or liability incurred, typically this situation indicates that other consideration (i.e., unidentifiable goods or services) has been (or will be) received by the entity. The entity shall measure the identifiable goods or services received in accordance with the IFRS 2. The entity shall measure the unidentifiable goods or services received (or to be received) as the difference between the fair value of the share-based payment and the fair value of any identifiable goods or services received (or to be received).'

The fair value of the instruments the entity issued to acquire the SPAC exceeds the fair value of the identifiable net assets acquired.

Therefore, the Committee observed that, in applying paragraphs 2 and 13A of IFRS 2, the entity:

a) receives a stock exchange listing service for which it has issued equity instruments as part of a share-based payment transaction; and

b) measures the stock exchange listing service received as the difference between the fair value of the instruments issued to acquire the SPAC and the fair value of the identifiable net assets acquired.

Depending on the specific facts and circumstances of the transaction, the entity issues ordinary shares-or ordinary shares and new warrants-in exchange for acquiring cash, for acquiring the stock exchange listing service and for assuming any liability related to the SPAC warrants.

Conclusion

The Committee concluded that the entity may apply the accounting of warrants as follows:

a) IFRS 2 in accounting for instruments issued to acquire the stock exchange listing service; and

b) IAS 32 in accounting for instruments issued to acquire cash and assume any liability related to the SPAC warrants—these instruments were not issued to acquire goods or services and are not in the scope of IFRS 2.

6. Definition of a lease – Substitution Rights (IFRS 16 Leases) – Tentative agenda decision November 22

Background

In the fact pattern described in the request:

- A customer enters into a 10-year contract with a supplier for the use of 100 similar new assets—batteries used in electric buses. The customer uses each battery together with other resources readily available to it (each battery is used in a bus that the customer owns or leases from a party unrelated to the supplier).
- Applying the requirements in paragraphs B14–B18, it is determined that the supplier has the practical ability to substitute alternative assets throughout the contract term such that the condition in paragraph B14(a) exists.
- If a battery were to be substituted, the supplier would be required to compensate the customer for any revenue loss or costs incurred while the substitution takes place. Whether substitution is economically beneficial for the supplier at a point in time depends on both the amount of compensation payable to the customer and the condition of the battery. At the inception of the contract, it is expected that the supplier would not benefit economically from substituting a battery that has been used for less than three years but could benefit economically from substituting a battery that has been used for three years or more.

Issue

a) The level at which to evaluate whether a contract contains a lease- by considering each asset separately or all assets together when the contract is for the use of more than one similar asset.

b) How to assess whether a contract contains a lease applying IFRS 16 when the supplier has particular substitution rights i.e., the supplier:

  (i) has the practical ability to substitute alternative assets throughout the period of use; but

  (ii) would not benefit economically from the exercise of its right to substitute the asset throughout the period of use.

Discussion

IFRS IC noted that Paragraph B12 of IFRS 16 states that 'an entity shall assess whether a contract contains a lease for each potential separate lease component' and directs an entity to paragraph B32 of IFRS 16 for application guidance on separate lease components. Paragraph B32 specifies that the right to use an underlying asset is a separate lease component if both:

a) the lessee can benefit from use of the underlying asset either on its own or together with other resources readily available to it; and

b) the underlying asset is neither highly dependent on, nor highly interrelated with, the other underlying assets in the contract.

In the fact pattern described in the request, the customer is able to benefit from use of each asset (a battery) together with other resources (a bus) available to it and each battery is neither highly dependent on, nor highly interrelated with, the other batteries in the contract. Therefore, the Committee concluded that, in the fact pattern described in the request, applying paragraph B12, the customer assesses whether the contract contains a lease including evaluating whether the supplier's substitution right is substantive for each potential separate lease component, i.e., for each battery.

Pertaining to second request, the committee noted that each battery is specified. Even if not explicitly specified in the contract, a battery would be implicitly specified at the time it is made available for the customer's use. Therefore, the Committee observed that, unless the supplier has the substantive right to substitute the battery throughout the period of use, each battery is an identified asset.

In the fact pattern described in the request, the condition in paragraph B14(a) the supplier has the practical ability to substitute alternative assets throughout the period of use is assumed to exist. The Committee observed, however, that the condition in paragraph B14(b) does not exist throughout the period of use because the supplier is not expected to benefit economically from exercising its right to substitute a battery for at least the first three years of the contract. Those years are part of the period of use. Consequently, the supplier's substitution right is not substantive throughout the period of use. Therefore, the Committee concluded that, in the fact pattern described in the request, each battery is an identified asset. To assess whether the contract contains a lease, the customer would then apply the requirements in paragraphs B21–B30 of IFRS 16 to determine whether, throughout the period of use, it has the right to obtain substantially all the economic benefits from use, and direct the use, of each battery.

Conclusion

The Committee concluded that the principles and requirements in IFRS 16 provide an adequate basis for an entity to evaluate the level at which to assess whether the contract contains a lease and whether there is an identified asset in the fact pattern described in the request. Consequently, the Committee decided not to add a standard-setting project to the work plan.

4. Implementation of reporting requirement under Companies (Audit and Auditors) Rules, 2014 [11(e) and 11(f)]

Companies may provide funds for the benefit of certain beneficiaries, but the funds may flow through another entity(ies) (acting as an Intermediary) such that the trail of such transactions is difficult to establish and there is no transparency about the identity of the ultimate party receiving the funds. The Intermediary acts as per the directions of the reporting entity ("the Funding Party") to pass on the funds received from the reporting entity to an entity identified by the reporting entity – i.e., the Ultimate Beneficiary.

To curb the flow of such transaction and to bring about better transparency, the Ministry of Corporate Affairs (MCA) issued notification on March 24, 2021, namely "Companies (Audit and Auditors) Amendment Rules, 2021" introducing new Rule 11(e) and 11(f). Auditor's reporting under Rule 11(e) and 11(f) is effective in respect of financial years commencing on or after 1 April 2021.

ICAI has brought "implementation guide on reporting under Rule 11(e) and 11(f) of the Companies (Audit and Auditor's) Rules, 2014" to provide appropriate guidance on the requirement of these rules.

Rule 11(e) deals with reporting on lending or receiving funds through pass through entities marked for ultimate beneficiary and new Rule 11(f) deals with reporting on the payment/ declaration of dividend.

Rule 11(e) of the Companies (Audit and Auditors) Rules 2014:

Requires the auditor to comment on certain transactions relating to funds advanced/received by entities. Rule 11(e) is reproduced below:

"(e) (i) Whether the management has represented that, to the best of it's knowledge and belief, other than as disclosed in the notes to the accounts, no funds have been advanced or loaned or invested (either from borrowed funds or share premium or any other sources or kind of funds) by the company to or in any other person(s) or entity(ies), including foreign entities ("Intermediaries"), with the understanding, whether recorded in writing or otherwise, that the Intermediary shall, whether, directly or indirectly lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the company ("Ultimate Beneficiaries") or provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries;

(ii) Whether the management has represented, that, to the best of it's knowledge and belief, other than as disclosed in the notes to the accounts, no funds have been received by the company from any person(s) or entity(ies), including foreign entities ("Funding Parties"), with the understanding, whether recorded in writing or otherwise, that the company shall, whether, directly or indirectly, lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the Funding Party ("Ultimate Beneficiaries") or provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries; and

(iii) Based on such audit procedures that the auditor has considered reasonable and appropriate in the circumstances, nothing has come to their notice that has caused them to believe that the representations under sub-clause (i) and (ii) contain any material misstatement."

MCA, vide notification dated 24 March 2021, has mandated additional disclosures by companies by amending Schedule III to the Companies Act, 2013 ("Act"). As per the said amendments following disclosure are required to be made for lending or receiving funds through pass through entities marked for ultimate beneficiary in the financial statements by the companies:

Applicability	Disclosure requirements
For transactions of loans and advances/ investments of funds	Companies (funding party) are required to disclose details of the transactions relating to advances or loans or investment of funds (either from the borrowed funds or share premium or any other sources or kind of funds), as prescribed, to any other person(s) or entity(ies), including foreign entities (Intermediaries) with the understanding (whether recorded in writing or otherwise) that the Intermediary shall: ▶ directly or indirectly lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the company (Ultimate Beneficiaries) or ▶ provide any guarantee, security, or the like to or on behalf of the Ultimate Beneficiaries The company shall disclose the following: (i) date and amount of fund advanced or loaned or invested in Intermediaries with complete details of each Intermediary. (ii) date and amount of fund further advanced or loaned or invested by such Intermediaries to other intermediaries or Ultimate Beneficiaries along with complete details of the ultimate beneficiaries. (iii) date and amount of guarantee, security or the like provided to or on behalf of the Ultimate Beneficiaries. (iv) declaration that the relevant provisions of the Foreign Exchange Management Act, 1999 and Companies Act has been complied with for such transactions and the transactions are not violative of the Prevention of Money-Laundering Act, 2002.
Companies which receive funds in the capacity of intermediaries:	Where a company has received any fund from any person(s) or entity(ies), including foreign entities (Funding Party) with the understanding (whether recorded in writing or otherwise) that the company shall: ▶ directly or indirectly lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the Funding Party (Ultimate Beneficiaries) or ▶ provide any guarantee, security, or the like on behalf of the Ultimate Beneficiaries, The company shall provide following disclosures: (i) date and amount of fund received from Funding parties with complete details of each Funding party. (ii) date and amount of fund further advanced or loaned or invested in other intermediaries or Ultimate Beneficiaries along with complete details of the other intermediaries' or ultimate beneficiaries. (iii) date and amount of guarantee, security or the like provided to or on behalf of the Ultimate Beneficiaries (iv) declaration that the relevant provisions of the Foreign Exchange Management Act, 1999 and Companies Act have been complied with for such transactions and the transactions are not violative of the Prevention of Money-Laundering Act, 2002.

Rule 11(f) of the Companies (Audit and Auditors) Rules 2014:

Whether the dividend declared or paid during the year by the company is in accordance with section 123 of the Companies Act 2013

By virtue of this new reporting requirement, auditors are now specifically required to comment on compliance with provisions of section 123 of the Companies Act 2013 with respect to the dividend declared or paid during the year by the company in their audit report. Accordingly, the reporting under Rule 11(f) will cover reporting for dividend (including interim dividend) which is declared or paid or proposed for the financial year under reporting but remaining unpaid as at the Balance Sheet date.

5. Presentation and Disclosures - key consideration

Introduction:

Financial statements are primary source of information to understand the financial health well-being of the company. The users are highly reliant on the information presented in the financial statements and therefore it's the responsibility of the Company to ensure that financial statements are correct and adhere to the applicable regulatory requirements.

Section A: Financial Reporting Review Board key disclosures considerations:

Financial Reporting Review Board (FRRB) of ICAI works toward improving and strengthening of financial reporting practices in the country.

FRRB has come out with its new publication on 'Study on Compliance of Financial Reporting Requirements (Ind AS Framework) – Volume II' in September 2022. The publication includes instances of non-compliances with respect to financial reporting requirements such as Ind AS, Standards on Auditing, Schedule III to the Companies Act, 2013, Companies (Auditor's Report) Order 2016 (CARO 2016) etc., observed by the FRRB during the course of review of general-purpose financial statements of various enterprises.

Following are certain key FRRB observations in respect of non-compliance of Ind AS and Schedule III disclosures.

1. Offsetting of deferred tax asset with deferred tax liabilities

As per Ind AS 12, "An entity shall offset deferred tax assets and deferred tax liabilities if, and only if:

a) the entity has a legally enforceable right to set off current tax assets against current tax liabilities; and

b) the deferred tax assets and the deferred tax liabilities relate to income taxes levied by the same taxation authority on either:

(i) the same taxable entity; or

(ii) different taxable entities which intend either to settle current tax liabilities and assets on a net basis, or to realize the assets and settle the liabilities simultaneously, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered."

FRRB noted that the company has presented deferred tax asset (DTA) and deferred tax liability (DTL) separately in their Standalone Financial Statements. The FRRB viewed that as per the requirements of Ind AS 12, deferred tax should be presented on a net basis on the face of Balance Sheet after offsetting the DTA and DTL.

2. Disclosure of MAT credit entitlement and Deferred tax as separate line items.

Company in its financial statements had presented the MAT credit entitlements and deferred tax as separate line items in the Statement of Profit and Loss

As per the Guidance Note on Division II - Ind AS Schedule III to the Companies Act, 2013, MAT credit should be grouped with deferred tax Accordingly, it was viewed that the requirement of the Guidance Note on Division II - Ind AS Schedule III to the Companies Act, 2013 has not been complied with.

3. Classification of fixed deposits held as margin money with in cashflow

As per Ind AS 7 "Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value".

Fixed deposit held as margin money with bank is neither in nature of demand deposit, nor readily available for use by company and accordingly do not meet definition of cash and cash equivalent. It is observed that, such fixed deposit was classified as cash and cash equivalent in cashflow, which is not in compliance with Ind AS 7.

For assessment of the classification of fixed deposit held as margin money as cash and cash equivalent or other bank balances, it is pertinent to note that careful analysis and consideration is given to the recent IFRIC Agenda decision on demand Deposits with restrictions on use arising from a contract with a third party – April 2022 (mentioned above) on whether an entity includes a demand deposit as a component of cash and cash equivalents in the statements of cash flows and financial position when the demand deposit is subject to contractual restrictions on use agreed with a third party.

These are very common non-compliances noted by FRRB. 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.

Jalpa Sonchhatra

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

4. **Calculation of basic and diluted earnings per share on issue of bonus shares**

As per requirement of Ind AS 33, in case of issue of bonus shares, calculation of basic and diluted earnings per share (EPS) for all periods presented will be adjusted retrospectively.

It was noted that the bonus shares were issued 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.

5. **Unpaid dividends**

It was noted by the FRRB that the Company had disclosed unpaid dividend under "Other financial liability" and one of the notes to accounts related to dividend it was disclosed that there was high court order restraining the Company from distributing any dividend or depositing the same in the dividend distribution account in accordance with the provisions of the Companies Act, 2013) which is pending for the final hearing.

The FRRB noted from the Cash Flow Statement that although a reconciliation of cash and cash equivalents has been disclosed by the company, however, no disclosure was made either in cash flow statement or notes to the account regarding amount of cash and cash equivalents which are not available for use. It was noted from the Note on Other Financial Liabilities that a liability toward 'unpaid dividends' had been disclosed thereat. Further, the company was prohibited from transferring the dividend amount to a separate bank account. Accordingly, it was viewed that cash and cash equivalents to the extent of amount of unpaid dividend is not available to the company for its use, and therefore, appropriate disclosure should have been made in this regard in line with paragraph 48 of Ind AS 7. Accordingly, it was viewed that the requirements of paragraph 48 of Ind AS 7 have not been appropriately complied with in preparation and presentation of the financial statements.

6. **Single reportable segment**

Ind AS 108 provides criteria for disclosure of reportable segments. It is observed that company having single reporting segment, disclosed such fact under 'significant accounting policies'. Although if the company is having a single reporting segment yet paragraph 31 of Ind AS 108 is applicable on it, and therefore, FRRB noted that disclosure requirement mentioned under paragraphs 32 to 34 of Ind AS 108 should have been disclosed by the company even for a single reportable segment. It is to be noted that, segment disclosure is not accounting policy per se and therefore should not be disclosed under note on 'significant accounting policy', rather same should have been disclosed as part of "Notes to Accounts"

7. **Deemed cost of investment in transition to Ind AS**

Ind AS 101 provides option to entity to measure investment in subsidiary, joint venture or associate at the carrying value of previous GAAP or cost in accordance with Ind AS 27 or at fair value upon transition to Ind AS.

Upon transition to Ind AS, the company presented investment in subsidiary and provision for diminution in value of investment separately. In the accounting policy of the company, it had not disclosed election of previous GAAP carrying value as policy.

When the option to use the deemed cost is not taken it implies that the relevant Ind AS is retrospectively applied by the entity to relevant items of the financial statements. Non-exercise of the option, in case of investments, implies that the company has measured the investments in subsidiaries at cost, in line with the requirement of Ind AS 27. Accordingly, the provision for diminution in the value of investment recorded under erstwhile IGAAP should have been reversed on the date of transition with a corresponding impact on retained earnings (or if appropriate another category of equity).

In case it is concluded that Ind AS 27 have been applied retrospectively, then the requirement of impairment assessment under Ind AS also needs to be assessed as of the transition date, and impairment provision as per Ind AS needs to be recognized in that case as well.

8. **Expected credit loss (ECL) on investment**

As per erstwhile AS 13, long term investment was measured at cost less permanent diminution in value of investment. It is observed that , under Ind AS still term "provision for diminution in value of investment" is used instead of " ECL or impairment"

9. **Other Comprehensive Income (OCI) in the case of Nil amounts reported in OCI.**

As per requirements of Division II of Schedule III, even if the amount of OCI is NIL, still it should be disclosed as part of total Comprehensive Income. Failure to disclose OCI was observed.

Section B: Frequently asked questions

Companies should ensure that Ind AS disclosures in financial statement complies with accounting standard issued by MCA and other regulatory authorities. While drafting disclosures, 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 commonly observed questions by various companies while drafting the disclosures

1. **How to disclose lease payments in a statement of cashflow?**

In statement of cashflow, lease payments are classified consistently with payments on other financial liabilities:

- The part of the lease payment that represents cash payments for the principal portion of the lease liability is presented as a cash flow resulting from financing activities.
- The part of the lease payment that represents interest portion of the lease liability is presented either as an operating cash flow or a cash flow resulting from financing activities applying the requirements in Ind AS 7, Statement of Cash Flows, for interest paid).
- Payments on short-term leases, for leases of low-value assets and variable lease payments not included in the measurement of the lease liability are presented as an operating cash flow.

2. How to do classification of derivatives as current vs non-current

An entity enters into derivative contracts. Depending on the situation and the accounting that the entity chooses, hedge accounting may or may not be applied.

Derivatives may involve a series of cash flows throughout the duration of the instrument (e.g., interest rate swaps), they may give rise to an exchange of cash flows only at maturity of the instrument (e.g., foreign currency swaps and futures), or they may give rise to daily settlement (e.g., settled-to-market derivatives). Settled-to-market derivatives are likely to be presented as current due to their daily settlement mechanism (if they have any fair value to present on the Statement of Financial Position at all).

An asset and a liability are separated into current and non-current portions based on the guidance in paragraphs 66 and 69 of Ind AS 1 *Presentation of Financial Statements.* If management holds a financial instrument primarily for the purpose of trading (irrespective of the timing of future cash flows) it is classified as current. If a financial instrument is not held primarily for the purpose of trading, the instrument should be presented as current or non current on the basis of its settlement or realization date (or dates if the derivative comprises a series of cash flows).

An entity may need to apply judgement in determining an appropriate split between current and non-current. That judgement should be applied consistently to similar instruments. If the derivative is not held primarily for the purposes of trading, the key principle is to determine the split based on how a derivative asset will be realized or a derivative liability will be settled.

Examples based on scenarios:

Sr. No	Scenarios	Current vs non-current
1	A derivative is entered into by an entity in order to gain from short-term price fluctuations. It is not used for hedging purposes.	Current
2	A derivative is entered into with the intention to hedge certain risks. Hedge accounting is not applied. The hedged item is a loan with fixed interest payments with a term of three years and annual payments. The derivative is a fixed-floating interest rate swap with the same life and the same notional amount and annual payments.	The portion of the derivative that will be realized/settled in the first 12 months is classified as current, with the remaining portion classified as non-current.
3	A derivative is entered into with the intention to hedge certain risks. Fair value hedge accounting is applied. The hedged item is a loan with fixed interest payments with a term of three years and annual payments. The derivative is a fixed-floating interest rate swap with the same life and the same notional amount and annual payments.	The portion of the derivative that will be realized/settled in the first 12 months is classified as current, with the remaining portion classified as non-current.
4	An embedded derivative is identified in a financial liability host contract. It is not considered closely related to the host contract and is accounted for separately at fair value and presented as a derivative asset or liability separately from the host financial liability. It is not held primarily for the purpose of trading.	Current or non-current consistent with how the embedded derivative will be settled. The portion of the derivative that will be settled in the first 12 months is classified as current, with the remaining portion classified as non-current.
5	An embedded derivative is either (a) considered closely related to the host contract and is not accounted for separately or (b) it is not considered closely related to the host contract and is accounted for separately at fair value with the hybrid contract presented as one financial liability measured at the sum of the carrying amounts of the host and the embedded derivative.	The embedded derivative is not presented separately in the balance sheet. The instrument, being the host and the embedded derivative, would be presented as current or non-current based on an assessment of how the instrument will be settled/realized and management's intention for holding the combined instrument. The portion that will be settled/realized in the first 12 months is classified as current, with the remaining portion classified as non-current.

3. Non-GAAP measures related considerations:

What are non-GAAP measures?

Financial statements are the cornerstone of financial reporting for entities. In addition to generally accepted accounting principles (GAAP) measures, management often uses a variety of other financial measures to communicate information about an entity's financial performance, financial positions and cashflow commonly known as "non-GAAP" measures.

Regulators in different jurisdiction have issued guidelines in the use of non-GAAP measures (e.g., International organization of securities commission, European Securities and Market Authorities etc).

There are no guidelines or regulations on the use of non-GAAP measures in India.

The Companies Act of 2013 and the earlier Companies Acts require companies to prepare the financial statements that give a true and fair view of their financial position and performance. The guidelines on disclosure of information by listed companies issued by the Securities and Exchange Board of India (SEBI) do not give reference to the use of non-GAAP measures.

However, companies may supplement GAAP earnings with non-GAAP measures, after considering the regulatory framework and disclosures required. The rationale is that, management may have alternative ways of representation company's "true" performance. Examples of non-GAAP measures are earnings before Interest, Taxes, Depreciation and Amortization, operating cashflows (EBITDA),free cashflow, grow margin, market capitalization etc.

Risk associated with non-GAAP measures:

Although non-GAAP financial measures are commonly used, they are not standardized and therefore may not be comparable from one industry to another or even one company to another. Differences in definitions, calculations, and presentations make these measures particularly susceptible to misunderstanding.

Good practices for non-GAAP measures disclosures:

In the absence of specific guidance for non-GAAP measures in India, drawing and analogy from other regulations, the company may consider followings while disclosing non-GAAP measures:

- non-GAAP measures must not be misleading
- A quantitative reconciliation of non-GAAP financial measures to the most comparable GAAP measures must be presented
- A statement indicating why the management believes that the non-GAAP measures provide useful information to investors. The statement should clearly define the purpose and use of non-GAAP measures.
- non-GAAP measures shall be resented with equal or greater prominence of the most directly comparable GAAP financial measures.
- non-GAAP measures shall be clearly labeled and described as "non-GAAP measures"
- non-GAAP measures should generally be calculated and presented for all periods presented. A non-GAAP measure may be considered misleading if the company adjusts an item in the current reporting period but does not adjust for a similar item in the prior period without appropriately disclosing the change and explaining the reasons for it.

6. Clarification issued by National Financial Reporting Authority

National Financial Reporting Authority (NFRA) during its disciplinary proceedings under section 132(4) the Companies Act, 2013 for professional misconduct of statutory auditor of a listed company, noted that the company in its financial statements, had discontinued accrual/recognition of interest expense on its bank borrowings, which had been reportedly classified as Non-Performing Asset (NPA) by the lender banks and for which the company was negotiating One Time Settlement with the banks. This accounting treatment was in contravention of the provisions of applicable accounting standard, as these borrowings as well the interest payable thereon continued to be the financial liabilities of the company and were required to be accounted for as amortized cost in accordance with the requirements of Indian Accounting Standard (Ind AS) 109, *Financial Instruments* (Ind AS 109).

The Company's discontinuation of the recognition of accrual of interest while calculating the amortized cost of the borrowings was in violation of Effective Interest Method (EIM) and Effective Interest Rate (EIR) principles and concepts underpinning the amortized cost measurement. It may be noted that the banks do discontinue recognition of interest income on the assets classified as NPA based on prudential guidelines of RBI. However, these guidelines also require the banks to maintain a Memorandum Record of Accrued Interest on NPAs, clearly reflecting the fact that the banks have not legally released the borrowers from their contractual liability to pay interest on their borrowings from the bank.

Taking the above mentioned facts into consideration, the NFRA concluded that discontinuation of interest expense recognition on bank borrowings solely based on the borrowing company's expectations of likely waiver/concession by the lender banks in the payment of interest/ principal without evidence of the legally enforceable contractual documents results in incorrect/ erroneous presentation of financial performance and financial position of the borrowing company to its shareholders, investors, creditors and lenders.

In order to ensure that such violations do not occur and to ensure presentation of true and fair view of the financial statements of the companies, NFRA issued a circular on 20 October 2022 on above subject to draw attention of all companies, audit committees, and statutory auditors. Also, Company Secretaries have been advised by NFRA to draw attention of the Board of Directors of their companies to the contents of the circular.

Section 2

Regulatory changes

1. Ministry of Corporate Affairs (MCA) notification

a. Use of an accounting software which records audit trail

MCA has amended the Companies (Accounts) Rules, 2014 relating to the manner of maintaining books of account in electronic mode. As per the amendment, every company which uses accounting software for maintaining its books of account, should use only such accounting software which has a feature of recording the audit trail of each transaction, creating an edit log of each change made in books of account along with the date when such changes were made and ensuring that the audit trail cannot be disabled. This amendment was applicable for the financial year commencing on or after 1 April 2022. Later MCA amended the proviso vide Companies (Accounts) Second Amendment Rules, 2022 and deferred the applicability by one year. The provision of audit trail is now applicable w.e.f. 1 April 2023 onwards.

MCA also amended Companies (Audit and Auditor) Rules, 2014 ("Audit Rules") Rule 11(g) to specify auditors reporting obligations with respect to audit trail. As per the amendment, auditor has to report whether the company, in respect of financial years commencing on or after the 1 April 2022 has used such accounting software for maintaining its books of account which has a feature of recording audit trail (edit log) facility and the same has been operated throughout the year for all transactions recorded in the software and the audit trail feature has not been tampered with and the audit trail has been preserved by the company as per the statutory requirements for record retention.

Applicability with reference to the implementation guide issued by ICAI:

- The requirements of the audit trail and edit log are applicable to the extent companies are maintaining their records in the electronic form. Where the records are entirely maintained manually – the assessment and reporting responsibility will not arise and accordingly, the same would need to be reported as statement of fact by the auditor against this clause.
- The date of applicability of audit trail requirements for the management succeeds the date from applicable to the auditor. Therefore, there is likely to be a scenario for the current year where in absence of compliance requirement (i.e., account rules effective from 1 April 2023) for the companies, auditors would not be able to report under the Audit Rules.

Companies need to gear up to upgrade their accounting system to comply with audit trail requirements w.e.f. 1 April 2023. The date of applicability of audit trail requirements for the management succeeds the date from applicable to the auditor (i.e., effective from 1 April 2022). In the absence of current year compliance requirement for the Companies, Statutory Auditor would not be able to report under 11 (g) of Audit Rules.

Dr. Devesh Prakash

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

- The reporting requirements have been prescribed for audit of financial statements prepared under the 2013 Act. Accordingly, auditors of all classes of companies, including section 8 companies, would be required to report on these matters. As per Companies (Registration of Foreign Companies) Rules, 2014 the provisions of Audit and Auditors (i.e., Chapter X of the 2013 Act) and Rules made thereunder apply, mutatis mutandis, to a foreign company. Accordingly, the above reporting requirements would be applicable to the auditors of foreign companies as well.
- The requirements of the audit trail are applicable to the extent a company maintains its records in the electronic form by using an accounting software. Thus, where the books of account are entirely maintained manually - the assessment and reporting responsibility under Rule 11(g) will not be applicable and accordingly, the same would need to be reported as statement of fact by the auditor against this clause.

Challenges that companies are facing to maintain the audit trail:

- ***Books of account – what is the breadth of coverage?***

Section 2(13) of Companies Act, 2013 defines books of account, which include records maintained in respect of :

(i) All sums of money received and expended by a company and matters in relation to which the receipts and expenditure take place.

(ii) All sales and purchases of goods and services by the company

(iii) The assets and liabilities of the company; and

(iv) The items of cost as may be prescribed under section 148 in the case of a company which belongs to any class of companies specified under that section. Companies may find it irrelevant to maintain an audit trail on each and every line item of the financial statements as it may become expensive to store the audit trail while the costs of monitoring would go up significantly and the effectiveness could reduce.

- ***What does an accounting software cover?***

Accounting Software is a computer program or system that enables recording, maintenance and reporting of books of account and relevant ecosystem applicable to business requirements. The functionality of such accounting software differs from product to product. Every organization today employs multiple software for accounting, its operations and other requirements like consolidation, collection of data. The accounting software which is relevant for maintaining books of account should be considered for enabling of audit trail as mentioned in the implementation guide of ICAI.

- ***Software of companies operating as part of international chains:***

There would be many companies which operate as part of international chains. For e.g., a company in the business of hotels run by an international chain generally uses robust software created for room revenues, food, and beverage, etc., which are tested centrally. Indian group companies which own the hotels may not be permitted to make any changes to these software and the extent of data visibility at the backend in terms of trails etc., may be visible only centrally at the Parent level of these operating international chains. It may be extremely difficult for Indian group companies to get access to such data.

- ***Ability of companies to invest in such software systems and cost of maintaining audit trail:***

All businesses are not set up with the best-in-class IT systems. It is only when an organization matures that it finds the ability to invest in good IT systems. Also, the cost of these IT systems does not involve only one time cost. They also include expensive upgrades, IT hardware, security systems, among others. Also, the audit trail and its storage would have a cost associated to it, which means larger the items and fields for which trails are to be maintained, more would be the cost of storage.

Thus, issues highlighted above indicate that implementing this notification in its current form would result in significant hardships for corporates. Hence, this notification would require significant clarity regarding possible situations and expectation of regulators for the foreseeable future.

MCA may consider providing clarifications on the following broad aspects:

- Summary of the expectations with respect to audit trails, especially with respect to assessing their effectiveness in achieving the desired goals
- Interplay with the internal controls with reference to financial statements, e.g., considering certain regulations like Sarbanes Oxley in the US, which provide generic requirements on audit trail
- Practical expedients for certain non-complex entities which are small in size, having transactions within the group
- The aspects/fields of accounting software which should have an audit trail
- The guidance may include a summary of the expectations with respect to audit trails especially with respect to assessing their effectiveness in achieving the goals as required by MCA
- The statutory auditors are required to specifically report on audit trail. Specific reporting considerations of the auditors may be clarified

Next steps for companies and auditors:

- Take an inventory of software in use by the company during the year.
- Identify the processes which are relevant from a financial statement perspective.
- Identify critical elements in each of the processes for which IT logs changes/trail may be required.
- Discuss the data requirement with the software vendors and the possibility and cost of generating and maintaining data.
- Discuss the approach for compliance with the MCA requirements with the Board/Audit Committee and the auditors.
- Identify areas/processes/elements in the processes for which trail is not possible/not feasible, etc.
- Assess reporting implications, both in the financial statements and in the auditor's report.

b. Corporate Social Responsibilities (CSR)

1. Amendment of the Companies (CSR Policy) Rules, 2014 of the Companies Act, 2013:

The MCA has amended the *Companies (Corporate Social Responsibility Policy) Rules, 2014*.

Below are the key amendments:

Sr. No	Rules	Amendment
1.	proviso to Rule 3(1)	A company having any amount in its Unspent Corporate Social Responsibility Account as per sub-section (6) of section 135 shall constitute a CSR Committee and comply with the provisions contained in sub-sections (2) to (6) of section 135.
2.	Rule 4(1) shall be substituted	The Board of the Company shall ensure that the CSR activities are undertaken by the company itself or through: a) a Section 8 company, or a registered public trust or a registered society, exempted under section 10(23C) or registered under section 12A and approved under section 80 G of Income Tax Act, 1961, established by the company, either singly or along with any other company; or b) a company established under section 8 of the Act or a registered trust or a registered society, established by the Central Government or State Government; or c) any entity established under an Act of Parliament or a State legislature; or d) a section 8 company, or a registered public trust or a registered society, exempted under section 10(23C) or registered under section 12A and approved under section 80 G of the Income Tax Act, 1961, and having an established track record of at least three years in undertaking similar activities. Explanation- For the purpose of clause (c), the term "entity" shall mean a statutory body constituted under an Act of Parliament or State legislature to undertake activities covered in Schedule VII (CSR activities) of the Act.
3.	Clause (C) of rule 8(3) shall be amended	A Company undertaking impact assessment may book the expenditure toward Corporate Social Responsibility for that financial year, which shall not exceed 2% of the total CSR expenditure or INR 50 lakhs whichever is higher.
4.	Annexure- II shall be amended	MCA has also amended Annexure - II of the rules relating to format for the Annual Report on CSR Activities to be included in the Board's Report for financial year commencing on or after 1 April 2020. Followings are the brief requirements: 1. Brief outline of CSR & CSR policy 2. Composition of CSR committee and attendance of the meeting 3. Weblink where CSR policy, committee members list and project details has been uploaded 4. Executive summary and impact assessment of CSR project undertaken 5. Disclosure regarding Average net profit, 2% of average net profit, surplus arising out of CSR project of preceding financial years, set off for current financial year and total CSR obligation for the financial year 6. Segregation of amount spent on CSR projects – Amount spent on project, administrative overhead, impact assessment and details of amount unspent for the financial year 7. Details of unspent CSR amount for the preceding three financial years 8. Details of capital assets acquired, if any, out of CSR fund 9. Reason for not spending 2% of average net profit

2. Clarification on spending of CSR funds for "Har Ghar Tiranga" campaign:

"Har Ghar Tiranga", a campaign under the aegis of Azadi Ka Amrit Mahotsav, was aimed at invoking the feeling of patriotism in the hearts of the people and to promote awareness about the Indian National Flag.

In this regard, it was clarified that spending of CSR funds for the activities related to this campaign, such as mass scale production and supply of the National Flag, outreach and amplification efforts and other related activities, are eligible CSR activities under item no. (ii) of Schedule VII of the Companies Act, 2013 pertaining to promotion of education relating to culture.

c. Other amendments

1. Companies (Specification of Definition Details) Amendment Rules 2022:

The MCA has increased the threshold limits of paid up capital and turnover limits of a small company to INR four crore and INR forty crore respectively for the purposes of sub-clause (i) and sub-clause (ii) of clause (85) of section 2 of the Companies Act, 2013 with effect from 15 September 2022.

2. Clarification: Rounding off requirements under Schedule III to the Companies Act, 2013:

MCA issued the following clarification on 26 September 2022, through important updates: Amendment to Schedule III to the Companies Act, 2013 vide notification dated 24 March 2021 mandates companies to round off the figures appearing in the Financial Statements depending upon their total income. However, it is clarified that if the companies provide absolute figures in e-forms, i.e., AOC-4, the same shall not be treated as incorrect certification by the Professionals.

3. Companies (Share capital and debentures) amendment rules, 2023

In case any buy back of securities, a declaration by minimum two directors including managing director, if any, is required to be filed with registrar certifying that buy-back has been made in compliance with the provisions of the Act with effect from 23 January 2023.

4. Companies (Appointment and Qualification of Directors) Amendment Rules, 2022

No application number shall be generated in case of the person applying for Director Identification Number is a national of a country which shares land border with India, unless necessary security clearance from the Ministry of Home Affairs, Government of India has been attached along with application for Director Identification Number. In case the person seeking appointment is a national of a country which shares land border with India, necessary security clearance from the Ministry of Home Affairs, Government of India shall also be attached along with the consent.

5. Companies (Prospectus and Allotment of Securities) Amendment Rules, 2022

Under private placement no offer or invitation of any securities under this rule shall be made to a body corporate incorporated in, or a national of, a country which shares a land border with India, unless such body corporate or the national, as the case may be, have obtained government approval under the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 and attached the same with the private placement offer cum application letter.

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

a. Amendment to Related Party disclosures

1. Clarification on applicability of Regulation 23 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 in relation to Related Party Transactions

Regulation 23 of the SEBI (Listing Obligations and Disclosure Requirements), Regulations 2015 ('LODR Regulations') was amended vide notification dated 9 November 2021, inter alia, enhancing the scope of related party, Related Party Transactions (RPTs) and the materiality threshold for seeking shareholder approval.

In regard to the same, SEBI has issued a circular dated 30 March 2022 for smooth implementation of the amended regulation 23 of LODR which is already effective from 1 April 2022.

Based on the representations received from listed entities and industry bodies, SEBI decided to provide the following clarifications and guidance for smooth implementation of the amended Regulation 23 of the LODR Regulations as follows:

Sr. No	Particulars	Clarification
1.	RPT approved prior to 1 April 2022	For an RPT that has been approved by the audit committee and shareholders prior to 1 April 2022, there shall be no requirement to seek fresh approval from the shareholders.
2.	Continuing RPTs becoming material	An RPT that has been approved by the audit committee prior to 1 April 2022 which continues beyond such date and becomes material as per the revised materiality threshold shall be placed before the shareholders in the first General Meeting held after 1 April 2022. Threshold for the material RPT shall be lower than the following: a) Exceeds Rupees 1,000 crores; or b) 10% of the annual consolidated turnover as per the last audited financial statements of the listed company
3.	RPTs which have received omnibus approval by the audit committee	An RPT for which the audit committee has granted omnibus approval, shall continue to be placed before the shareholders if it is material in terms of Regulation 23(1) of the LODR Regulations.
4.	Explanatory statement	Transparency, accountability and shareholder empowerment are the bedrock of robust corporate governance. Listed entities, therefore, shall ensure to comply with the spirit of the law and endeavor to provide relevant and detailed information to enable and empower shareholders for taking an informed decision. Explanatory Statement contained in the notice sent to the shareholders for seeking approval for an RPT shall provide relevant information so as to enable the shareholders to take a view whether the terms and conditions of the proposed RPT are not unfavorable to the listed entity, compared to the terms and conditions, had similar transaction been entered into between two unrelated parties. The information so provided shall include but not be limited to the information specified in Circular dated 22 November 2021 so as to enable to the shareholders to take an informed decision.

2. Clarification on applicability of Regulation 23(4) read with Regulation 23(3)(e) of the SEBI LODR in relation to RPTs.

Regulation 23(4) of the SEBI LODR Regulations requires shareholder approval for material RPTs.

Regulation 23(3)(e) of the SEBI LODR Regulations specifies that omnibus approval granted by the audit committee shall be valid for a period not exceeding one year and shall require fresh approvals after expiry of one year.

Section 96(1) of the Companies Act, 2013 specifies that the time gap between two Annual General Meetings (AGMs) cannot be more than fifteen months.

In order to facilitate listed entities to align their processes to conduct AGMs and obtain omnibus shareholders' approval for material RPTs, SEBI has decided to specify that the shareholders' approval of omnibus RPTs approved in an AGM shall be valid up to the date of the next AGM for a period not exceeding fifteen months. In case of omnibus approvals for material RPTs, obtained from shareholders in general meetings other than AGMs, the validity of such omnibus approvals shall not exceed one year.

b. Amendment relating to SEBI (LODR) Listing Obligations and Disclosure Requirement

1. SEBI in its board meeting held on 15 February 2022 decided to amend / issue various regulation which include:

Alignment of regulatory framework for 'security cover', disclosure of credit ratings and due diligence certificate.

The Board approved the following amendments to following regulations:

- SEBI (Debenture Trustee) Regulations, 1993,
- SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021
- SEBI (Listing Obligations and Disclosure Requirements), 2015

In order to align the regulatory framework for 'security cover' the term ' asset cover' has been substituted with the term 'security cover' in SEBI (Debenture Trustee) Regulations, 1993, and SEBI (Listing Obligations and Disclosure Requirements), 2015.

The SEBI has approved the amendments in SEBI (LODR), 2015 for prescribing the maintenance of security cover sufficient to discharge both principal and interest thereon.

SEBI has also given its approval for rationalizing the disclosure requirement with regard to Credit Ratings. SEBI has decided to put in place the requirement of due diligence certificate for unsecured debt securities in the SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021.

2. SEBI in its board meeting held on 30 September 2022 has decided to amend / issue various regulations which include:

Flexibility in approval process for appointment and / or removal of Independent Directors - Amendments to the SEBI (LODR) Regulations

In the SEBI (LODR) Regulations, 2015, the Board approved the proposal to introduce a new optional provision for appointment or removal of Independent Directors in listed entities, in move to provide flexibility to such a process.

As per the existing requirement under the LODR Regulations, appointment, re-appointment or removal of Independent Directors is to be made through a special resolution. For special resolution to be passed, 75% of votes are needed from company's board.

An alternative method for the appointment and removal of Independent Directors appointed for the first term has been approved by the Board. Under the alternate mechanism, if the special resolution for appointment of an Independent Director does not get the requisite majority, then the following thresholds would be tested:

a) Threshold for Ordinary Resolution

b) Threshold for Majority of minority shareholders

If the resolution crosses the above two thresholds, in the same voting process, then such a resolution for appointment of the Independent Director would be deemed to be approved by shareholders. The same threshold will also be applicable for the removal of an Independent Director appointed under this alternate mechanism.

To summarize, if a special resolution for the appointment of an independent director fails but the votes casted in favor of the resolution exceed the votes casted against the resolution and in a shareholder meeting, the votes casted by the public shareholders in favor of the resolution exceed the votes casted against the resolution, then such appointment/removal shall be deemed to have been made.

Amendment to SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 in the context of scheme of arrangement

In the context of the scheme of arrangement, an amendment was made to SEBI Listing Obligations and Disclosure Requirements Regulations, 2015. The amendment deals with the listing of securities arising out of a scheme of arrangement and provides for the disclosures of certain information by the listed entity to the stock exchange. The amendment also lays down the conditions under which such securities can be listed and traded on the stock exchanges.

The key amendments are:

1. Introduction of provisions pertaining to schemes of arrangement for entities which have listed Non-convertible Debt Securities/ Non-convertible Redeemable Preference Shares viz. filing of draft schemes of arrangement/ schemes of arrangement with Stock Exchange(s) for obtaining the No-objection letter, the process to be followed by the Stock Exchange(s) including forwarding the draft schemes to SEBI and consequential fee payments.
2. Any amount lying unclaimed in the escrow account for more than seven years pertaining to non-convertible securities issued by listed entities which do not fall within the definition of 'company' under the Companies Act, 2013 and the Rules made thereunder and are governed by separate statutes, shall be transferred to the Investor Protection and Education Fund created by SEBI.
3. Easing of the requirements/ timelines pertaining to submission of financial results, clarity in provisions pertaining to disclosure of line items/ ratios, publication of results in newspapers, etc. thereby bringing about uniformity in the disclosure requirements in parity with those for specified securities.

The amendment is aimed at improving transparency and accountability in the listing process and ensuring that the interests of all stakeholders are protected.

Disclosure of Key Performance Indicators (KPIs) and price per share of issuer, in Public Issues, based on past transactions and past fund raising from the investors

The Board approved the proposal to mandate the issuers coming out with Initial Public Offer (IPO), to make disclosure of Key Performance Indicators (KPIs) and price per share of issuer based on past transactions and past fund raising done by the issuer from the investors under 'Basis for Issue Price' section of the offer document, and in Price Band Advertisement.

Presently, Issuer companies, in addition to the audited financial numbers, also disclose their key numbers on various key performance metrics/indicators in different sections of Draft Red Herring Prospectus (DRHP) which are not covered in the financial statements in the offer documents.

Issuer shall disclose details of the pricing of shares based on past transactions and past fund raising from investors by issuer prior to IPO as under:

a. Disclose price per share of Issuer Company based on primary / new issue of shares and based on secondary sale / acquisition of shares, during the 18 months period prior to IPO

b. In case there are no such transactions during the 18 months period prior to IPO, then information shall be disclosed for price per share of Issuer Company based on last five primary or secondary transactions, not older than three years prior to IPO

c. Disclose Weighted Average Cost of Acquisition (WACA) based on primary/ secondary transaction(s) and IPO floor price and cap price being number of times the WACA in the offer document and in the Price Band Advertisement

d. Committee of Independent Directors shall recommend that the price band is justified based on quantitative factors / KPIs vis-à-vis the WACA of primary issuance / secondary transaction(s)

At times companies offer their share in IPO at prices which are much higher than the prices at which they had placed their shares to handful investors. After this decision, companies that want to go public will have to disclose the reasons behind any price difference between IPO price and pre-IPO prices.

Also, KPI will be different for different companies in terms of business models they follow. The disclosures would reduce the disclosures asymmetry for investor.

3. Disclosure of holding of specified securities and holding of specified securities in dematerialized form.

SEBI issued a circular dated 30 June 2022, which came into force with effect from the quarter ended 30 September 2022, relating to the disclosure of holding of specified securities and holding of specified securities in dematerialized form.

Regulation 31 of SEBI (LODR) deals with the disclosure of shareholding pattern and manner of maintaining shareholding in dematerialized format.

Accordingly, SEBI issued a circular dated 30 November 2015 (as amended) prescribed formats for disclosure of holding of specified securities and shareholding pattern under Annexure-I to the Circular.

In the interest of providing further clarity and transparency in the disclosure of shareholding pattern to the investors in the securities market, the Circular is being partially modified as under:

a. Clause 2(d) of the Circular has been amended as under:

   i) In the disclosure of public shareholding, names of the shareholders holding 1% or more than 1% of shares of the listed entity is to be disclosed.

   ii) Names of the shareholders who are persons acting in concert, if available, shall be disclosed separately.

b. The following formats specified in Clause 5 of the Circular have been modified:

   i) Table III - Statement showing shareholding pattern of the public shareholder.

   ii) Table IV - Statement showing shareholding pattern of the Non-Promoter - Non-Public shareholder.

c. It is also specified that all listed entities shall disclose details pertaining to foreign ownership limits in the format prescribed.

4. Amendments to regulation 25 and 52 of LODR regulations:

SEBI has amended regulation 25 and 52 of the SEBI (LODR) Regulations, 2015 (LODR) which mainly includes:

- ***Submission of financial results:***

The SEBI introduced the following amendments for listed entities which have Non-Convertible Securities (NCS)

Timelines for submission of results:
As per the existing provisions of Regulation 52, every listed entity that issued NCS is required to prepare and submit un-audited or audited quarterly and year to date standalone financial results on a quarterly basis in the format specified by SEBI within 45 days from the end of the quarter other than for the last quarter. The SEBI introduced a new proviso to clarify the timeline for the submission of the financial results for the last quarter. It provides that the listed entity that issued NCS can submit its un-audited or audited quarterly and year to date standalone financial results within 60 days from the end of the last quarter to the recognized stock exchange

Disclosures of ratios:
Regulation 52(4) states that, listed entities are required to disclose certain ratios/financial information in the quarterly and annual financial results

The SEBI through its recent amendments provided that the following ratios should be disclosed:

- Debt-equity ratio
- Debt service coverage ratio
- Interest service coverage ratio
- Outstanding redeemable preference shares (quantity and value)
- Capital redemption reserve/debenture redemption reserve

- Net worth
- Net profit after tax
- Earnings per share
- Current ratio
- Long term debt to working capital
- Bad debts to account receivable ratio
- Current liability ratio
- Total debts to total assets
- Debtors' turnover
- Inventory turnover
- Operating margin percent and
- Net profit margin percent

In case these ratios or information are not applicable to a listed entity, it should disclose other ratio/equivalent financial information, as may be required under applicable law, if any.

Timeline for submission of statement indicating the utilization of the issue proceeds:
Currently, Regulation 52(7) and Regulation 52(7A) of the LODR Regulations require a listed entity that has issued NCS to submit to the stock exchange(s), a statement indicating the utilization of the issue proceeds of non-convertible securities and statement disclosing material deviation(s) in the use of issue proceeds of non-convertible securities from the objects of the issue, in the format specified by SEBI within 45 days from the end of every quarter.

SEBI has amended that a listed entity should submit such statements along with the quarterly financial results.

Newspaper advertisement:
Currently, Regulation 52(8) requires a listed entity to publish its financial results and provide the details of ratios and financial information, in at least one English national daily newspaper circulating in the whole or substantially the whole of India, within two working days of the conclusion of the board meeting. SEBI has clarified that a listed entity that has issued NCS and it submitted both standalone and consolidated financial results, then it shall publish the consolidated financial results along with the ratios and financial information in the newspaper

For listed entities required to be audited by Comptroller and Auditor General of India ("C&AG") (Regulation 52 as per SEBI LODR (Sixth amendment) Regulations, 2022 w.e.f. 14 November 2022):
Issuers which are required to be audited by the C&AG under applicable law, shall submit to the stock exchange(s):

(i) un-audited financial results along with the limited review report issued by the Comptroller and Auditor General of India or an auditor appointed by the Comptroller and Auditor General of India or a Practicing Chartered Accountant, to the stock exchange(s), within sixty days from the end of the financial year; and

(ii) the financial results, audited by the Comptroller and Auditor General of India, to the stock exchange(s), within nine months from the end of the financial year

5. Draft Scheme of Arrangement and Scheme of Arrangement:

The SEBI has issued new Regulations 59A to introduce the following provisions relating to the scheme of arrangements for entities which have Non-convertible Debt securities (NCDs) or Non-Convertible Redeemable Preference Share (NCRPS). The key provisions are:

Every listed entity with NCDs/NCRPS that intends to undertake a scheme of arrangement or is involved in a scheme of arrangement as per the provisions of the Companies Act, 2013 (2013 Act), should file the draft scheme of arrangement with the stock exchanges along with a non-refundable fee to obtain a no-objection letter. This letter would be valid for a period of six months within which the draft scheme of arrangement should be filed by the listed entity with the National Company Law Tribunal (NCLT)

A listed entity should place the no-objection letter of the stock exchange(s) before the NCLT at the time of seeking approval for the scheme of arrangement. Upon sanction of the scheme by the NCLT, the listed entity would submit the prescribed documents to the stock exchange(s)

The above-mentioned amendments are effective from 14 November 2022.

6. Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2023:

SEBI has inserted a clause in paragraph C of Schedule V, i.e., "Details of material subsidiaries of the listed entity, including the date and place of incorporation and the name and date of appointment of the statutory auditors of such subsidiaries".

Thus, listed entities shall provide the details of the material subsidiaries of the listed entity, including the date and place of incorporation and the name and date of appointment of the statutory auditors of such subsidiaries.

c. Amendment relating to Issue of Capital and Disclosure Requirements (ICDR)

Over the past year SEBI has made various amendments to the Issue of Capital and Disclosure Requirements (ICDR) Regulations and continues consultation on various matters for e.g., corporate governance for listed entities, special rights to certain shareholders etc. with the view to increase transparency (availability of information between private and public investors), protect investors and enhance Indian capital markets.

The key amendments are as follows:

- Pricing of the issue
- Key Performance Indicators (KPIs) disclosure
- Introducing pre-filing of draft offer document (confidential filing)
- Introduction of Social Stock Exchange
- Changes in monitoring agency functions

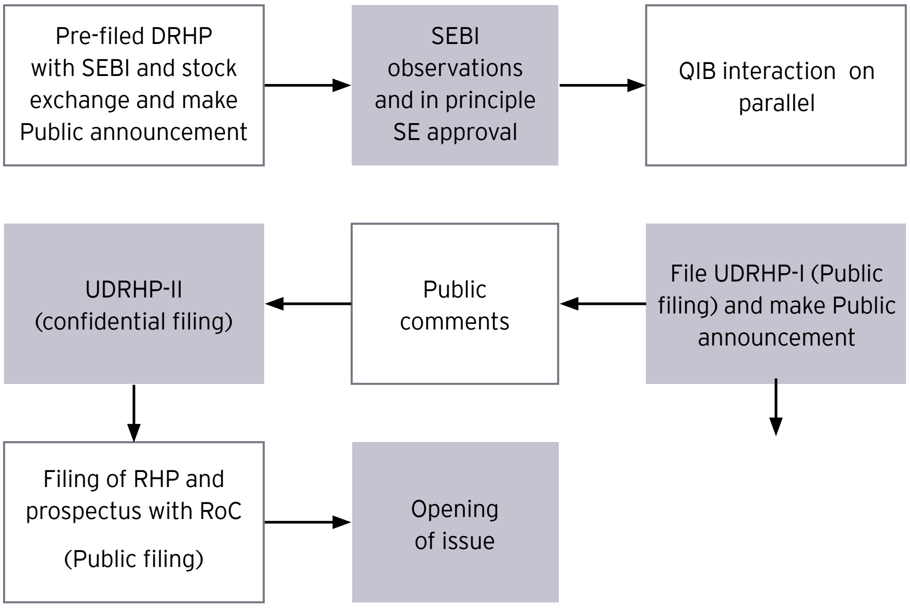
a) Pricing

- Recommendation of a Committee of independent directors of the issuer to determine that the price band is justified based on quantitative factors / KPIs vis-à-vis the Weighted Average Cost of Acquisition (WACA)
- Disclosure of floor price and cap price to be "x" times of WACA in the price band advertisement
- Disclosure of the floor price and cap price being "x" times the weighted average cost of acquisition based on the allotments/acquisitions ("WACA"), together with a detailed explanation and comparison of KPIs and financial ratios for the last three financials years and any stub period

b. Key Performance Indicators

- Companies have to now disclose how KPIs have been used by management historically to analyze, track or monitor operational and/or financial performance
- KPIs disclosed to investors in the past 3 years have to be disclosed, with the Audit Committee confirmation that verified and audited details for all the KPIs disclosed to investors are provided
- Comparison of KPIs with India listed peer companies and/or globally listed peer companies to be done as the case may be wherever available. If one-on-one comparison is not possible, then notes to explain the differences may be included
- Certification of KPIs by the statutory auditor or peer reviewed chartered/ cost accountant to be included in material documents
- Annual disclosure of KPIs to be provided for at least a year after listing or until all issue proceeds have been utilized (whichever is later)

c. Pre-filing of draft offer document includes:



Key amendments to ICDR regulations is a glide path for moving toward good practices which will improve the communication of Companies with their stakeholders. Appropriate disclosures on all parameters that are relevant for assessing the issuer's performance (for both profitable and loss-making companies) are required for helping investors to take informed decision.

Veenit Surana

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

- Pre-filing of offer document (Draft Red Herring Prospectus (DRHP)) has been included in newly introduced Chapter II A of the regulation
- SEBI observations to be made within 30 days on the Pre-filed DRHP
- Updated draft offer document-1 to be filed within 16 months of SEBI observations
- Receipt of in-principal approval from stock exchanges
- Public comments on the UDRHP-1 can be provided for 21 days
- Filing is also further done updating the draft offer document with SEBI incorporating public comments i.e., UDRHP-II
- UDRHP-II is filed with Registrar' of Companies followed by copies sent to SEBI and Stock Exchanges
- The issue has to be opened within 18 months of issuing SEBI observations in the case of confidential (Chapter II regime) filing. The existing regime provided for SEBI's final observations on the DRHP continues to remain valid for a period of 12 months.
- The one year holding period for selling shareholders under the Pre-filing option is to be considered from the date of filing of UDRHP-1 (which would otherwise be counted from the date of filing of the draft offer document)
- A conditional interaction with Qualified Institutional Buyers ("QIBs") is permitted and UDRHP-I may only be filed with SEBI seven working days after SEBI is informed of the closure of interactions with QIB

Pre-filing of the document enables discussions with SEBI on a confidential basis and resolves disclosure concerns with regulator before going public. A similar practice of confidential filing is followed by some global jurisdictions.

d. Social Stock Exchange

- The concept of Social Stock Exchange was introduced.
- Non-profit organizations and for-profit social enterprises can register with a Social Stock Exchange and raise funds.

Social Stock Exchange provides a new source of capital that can help to fund operations of social enterprises.

e. Monitoring agency

- Only credit rating agency registered with the board can be appointed
- The agency has to now submit a report till 100% of the proceeds have been utilized

If the issue size, excluding the size of offer for sale by selling shareholders, exceeds one hundred crore rupees, the issuer shall make arrangements for the use of proceeds of the issue to be monitored.

The issuer shall, within forty-five days from the end of each quarter, publicly disseminate the report of the monitoring agency by uploading the same on its website as well as submitting the same to the stock exchange(s) on which its equity shares are listed.

Usage of proceeds is now monitored till 100% of proceeds are utilized (earlier 90%) and only SEBI registered credit rating agencies are permitted to act as monitoring agencies (earlier scheduled commercial banks and public financial institutions)

f. Senior management

- Definition of Senior Management has been introduced for disclosures in the offer document
- Key managerial personnel and Senior management definition is separated

Thus, widening the scope of definition of Senior Management

Definition of senior management states that it shall mean the officers and personnel of the issuer who are members of its core management team, excluding the Board of Directors, and shall also comprise all the members of the management one level below the Chief Executive or Managing Director or Whole Time Director or Manager (including Chief Executive Officer and Manager, in case they are not part of the Board of Directors) and shall specifically include the functional heads, by whatever name called and the Company Secretary and the Chief Financial Officer.

Section 3

Key hot-topics

1. Accounting matters on account of political and economic uncertainty

Current economic environment

In 2022, there has been significant market volatility in commodity prices, high inflation, high interest rates and increasing energy prices. Interest rates have increased globally and entities that have debts face increased borrowing costs and higher refinancing costs in the future.

Many Ind AS requires discounting, for example, to measure non-current assets and liabilities, which may affect impairment calculations and the measurement of liability provisions, retirement obligations, leases, financial instruments and revalued tangible and intangible assets, among others. Further, Ind AS also specifically refers to inflation as one of the assumptions to be considered for measurement purposes. For example, Ind AS 19 Employee Benefits in accounting for long-term post-employment benefits and Ind AS 36 Impairment of Assets for asset impairments.

Accounting Considerations

Impairment:

Ind AS 36 requires an entity to test all assets that are within its scope for potential impairment when indicators of impairment exist and, at least annually for goodwill, intangible assets not yet available for use and intangible assets with indefinite useful lives. An asset is impaired when an entity is not able to recover its carrying value, either by using it or selling it.

Indicators of impairment may include both external and internal sources of information. The indicators mentioned in Ind AS 36 include, for example:

- Significant changes in commodity prices, inflation, market interest rates or other market rates of return on investments if these are likely to affect the key assumptions used in calculating an asset's value in use and decrease the asset's recoverable amount materially
- Significant changes with an adverse effect on the entity that has taken place during the period, in the technological, market, economic or legal environment in which the entity operates or in the market to which an asset is dedicated
- The carrying amount of the entity's net assets is more than its market capitalization, for example, evidenced by a decrease in share price of the entity
- Evidence of obsolescence, theft, seizure or physical damage of an asset
- Internal reports that indicate that the economic performance of an asset is, or will be, worse than expected

The above indicators stated in Ind AS 36 signify that political and economic environment in which the entity exit has a bearing on the financial information presented. Assessing the impact of any such external factors requires careful consideration while determining the value of assets held by the entity.

Expected Credit Loss

Entities with lending activities and corporate entities with trade receivables will need to consider the requirements in Ind AS 109 *Financial Instruments* when measuring expected credit losses (ECLs) on loans and trade receivables made or committed to entities impacted by the current economic environment. Entities will also need to consider ECLs relating to bank deposits and debt securities issued (including governments).

The ECL models will need to consider the current macroeconomic and geopolitical uncertainty by reflecting a probability-weighted amount determined by evaluating a range of possible outcomes, using information about past events, current conditions and forecasts of future economic conditions. Entities will need to consider whether the disclosures required by Ind AS 107 *Financial instruments: Disclosures* appropriately explain the risks and basis for estimating the expected credit losses.

Hyper-inflation

Background:

In an environment where significant levels of inflation exist, the usefulness of reporting is hindered. Changes in the 'real' growth of revenues and expenses cannot be discerned, and the values of assets and liabilities ordinarily measured on a historical cost basis are not reflective of their true value at the reporting date. In addition, the loss in value of items of a monetary nature is not reflected.

Accounting standards are applied on the assumption that the value of money is constant over time. However, when the effect of inflation on the value of money is significant, the usefulness of historical cost based financial reporting is often reduced.

Accounting considerations:

Ind AS 29 does not establish an absolute inflation rate at which an economy is considered hyper-inflationary. Instead, it considers a variety of non-exhaustive characteristics of the economic environment of a country that are seen as strong indicators of the existence of hyper-inflation.

It requires a restatement approach, whereby financial information recorded in the hyper-inflationary currency is adjusted by applying a general price index and expressed in the measuring unit current at the end of the reporting period (i.e., the accounting value is adjusted for a factor of current purchasing power). This process aims to improve comparability between periods by restating financial information for changes in the purchasing power of money.

All items are restated from their amounts as determined by other standards, and comparative figures are restated in terms of the measuring unit current at the end of the current reporting period to allow meaningful financial reporting by entities that operate in these hyper-inflationary economies.

Key requirement:

Restatement of financial statements in accordance with Ind AS 29 can be seen as a process comprising the following steps:

- Selection of a general price index
- Analysis and restatement of the Balance sheet
- Restatement of the statement of changes in equity
- Restatement of the statement of profit or loss
- Calculation of the gain or loss on the net monetary position and
- Restatement of the statement of cash flows

When an economy ceases to be hyper-inflationary, entities discontinue preparation and presentation of financial statements in accordance with Ind AS 29. The amounts expressed in the measuring unit current at the end of the previous reporting period will be treated as the basis of the carrying amounts of items in its subsequent statement of Balance sheet .

Disclosures

Entities need to consider the magnitude of the disruptions caused by the current economic environment and consider whether there is adequate disclosure of the information about those assets and liabilities that are subject to significant estimation uncertainty, in order to provide users with a better understanding of the financial impact. Ind AS 1 *Presentation of Financial Statements* (Ind AS 1) requires additional disclosures about these uncertainties as well as the judgements made.

Such disclosure may include, for a financial statement item with a carrying amount that is volatile, sensitivity analysis indicating how carrying amounts are impacted by the methods, assumptions and estimates underlying their calculation.

The current economic uncertainty may result in obligations or uncertainties that an entity may not have previously recognized or disclosed. As such, the entity needs to consider whether to disclose additional information in the financial statements to explain the impact on areas that might include going concern uncertainties, uncertainties about its ability to meet covenants in future periods, provisions, and contingent assets/liabilities, etc.

2. Climate-related matters in financial statements

Climate-related matters in financial statements:

Regulators have an increasing focus on climate-related issues, including the need for consistency between the front part (management commentary) and the back end (financial statements) and it is imperative for entities to consider what impact climate-related risks may have on their financial statements.

Investors and other stakeholders are also increasingly interested in the impact of climate change on entities' business models, cash flows, financial position and financial performance.

While Indian Accounting Standards (Ind AS) do not explicitly refer to climate-related matters, entities must consider them in applying Ind AS when the effect of those matters is material.

While climate-related matters and risks may impact a number of areas across industries and entities, we believe that for the FY 2022-23 financial statements, entities need to pay particular attention to the following: valuations such as those relied on in the context of impairment considerations and fair value measurements, and estimates, such as those used when measuring restoration provisions and useful lives of property, plant and equipment, including the impact of pollutant pricing mechanisms, economic incentives for achieving reductions in emissions, CO2 emissions pricing measures and also the future pricing of commodities.

As climate-related matters continue to evolve and entities make further commitments and take additional actions to tackle climate change, it is important to ensure that their financial statements reflect the most updated assessment of climate-related risks and their impact on the financial statements.

Accounting for climate change:

Particulars	Effects of climate related matters on financial statements
Ind AS 2 (Inventories)	Inventories becoming obsolete due to decrease in their selling prices and increase in their costs of completion.
Ind AS 12 (Income Taxes)	A company's estimate of future taxable profits may be affected and may result in the company being unable to recognize deferred tax assets or being required to derecognize deferred tax assets previously recognized.
Ind AS 16 (Property, plant & equipment)	***Useful life and Residual value:*** Climate-related matters may affect the estimated residual value and expected useful lives of assets because of obsolescence, legal restrictions on the assets ***Decommissioning:*** If the useful life of an item of PP&E is shorter than previously expected, it would result in earlier decommissioning and would increase both the decommissioning provision and the decommissioning component of the asset as a result of the discounting effect.
Ind AS 36 (Impairment of assets)	▶ Significant exposure to climate change risk and its impact on projected growth rate. ▶ Due to climate change, significant difficulties in preparing future cash flow projections beyond the next few years. ▶ Key to understand whether the investment is required to continue operating the assets and, therefore, would be akin to maintenance.
Ind AS 37 (Provisions, contingent liabilities and contingent assets)	Actions to address the consequences of climate change may result in: ▶ Recognition of new liabilities or the disclosure of new contingent liabilities. ▶ Past judgements may be required to be reconsidered. ▶ Contracts may become onerous.
Ind AS 109 (Financial Instruments)	Climate related matters may affect: ▶ A lender's exposure to credit losses ▶ Market participants' views of potential climate-related legislation could affect the fair value of an asset or liability. ▶ In the case of borrower, where loan contracts include terms linking contractual cash flows to a company's achievement of climate related targets, those targets may affect assessment of whether there are embedded derivatives that need to be separated from the host contracts. Whereas, in the case of investor in such instruments, a careful analysis of SPPI test is required.
(Key estimates and Judgements) as required by Ind AS 1	▶ Climate risk is becoming a major source of estimation uncertainty and could add complexity to the application of Ind-AS ▶ Disclosure of assumptions in respect of climate-related matters may be required. ▶ It may be necessary to provide sensitivity analysis for a range of scenarios.

Impact

The determination of the effects of climate change on an entity's financial statements may require significant effort and judgement. Entities may need to provide additional disclosures in their financial statements in order to meet the standards' disclosure objectives. Hence, in determining the extent of disclosure, entities are required to carefully evaluate what information is required for users to be able to assess the effects of climate change on their financial position, financial performance, and cash flows.

Climate risk and other climate-related matters may impact a number of areas of accounting. While the immediate impact to the financial statements may not necessarily be quantitatively significant, there are increasing expectations from stakeholders that entities explain how climate-related matters are considered in preparing their financial statements to the extent they are material from a qualitative perspective. Stakeholders also expect robust disclosures on the most significant assumptions, estimates and judgements made related to climate change.

Jigar Parikh

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

Sustainability requirements:

Business Responsibility and Sustainability Reporting ('BRSR'), which was voluntary as a part of the regulatory provisions for the top 1000 listed entities (by market capitalization) for FY 2021-22, has now become mandatory from FY 2022-23. In line with these developments, the Securities and Exchange Board of India (SEBI), in its continued efforts to enhance disclosures on ESG standards, introduced new requirements for sustainability reporting. The new reporting format), aims to establish links between the financial results of a business with its ESG performance. The revised disclosures are based on the National Guidelines for Responsible Business Conduct (NGRBC).

Quantitative and qualitative disclosures:

Disclosure requirements are divided into three sections:

- **Section A:** General disclosures: This section contains basic information about the entity such as size, location, products, number of employees, CSR activities, etc.
- **Section B:** Management and process disclosures: The disclosures in this section would enable listed companies to demonstrate structure, policies and processes put in place by them toward adopting the NGRBC principles and core elements.
- **Section C:** Principle-wise performance disclosures: The disclosures in this section would enable listed companies to demonstrate their performance by integrating the principles and core elements with key processes and decisions. Each principle is divided into:
  a) Essential indicators: to be reported on mandatory basis
  b) Leadership indicators: to be reported on voluntary basis

Impact

BRSR is a "statement of measures, metrics and milestones" of actions taken by a corporate. The data points required by the framework should meet the test of availability, accessibility, accuracy, and auditability. Given that the data reported is non-financial in nature and needs to be gathered from multiple sources, its reliability assumes great significance. Hence, companies should consider obtaining independent assurance to stand by the disclosures it makes.

3. Accounting for Production Linked Incentive (PLI) Scheme

The Production Linked Incentive (PLI) scheme was originally introduced by the Government of India covering three sectors vide Gazette Notification No. CG-DL-E-01042020-218990 dated 1 April 2020, and Gazette Notification No. CG-DL-E-21072020-220617 dated 21 July 2020 viz.,

(i) mobile manufacturing and electric components,

(ii) pharmaceutical (critical key starting materials / active pharmaceutical ingredients)

(iii) medical device manufacturing

Since then, the coverage of PLI has been expanded, with schemes being rolled out for multiple sectors to boost India's manufacturing capabilities and encourage export-oriented production. Presently, PLI Schemes cover various sectors, including auto components, automobile, aviation, chemicals, electronic systems, food processing, medical devices, metal and mining, pharmaceuticals, renewable energy, telecom, textiles and apparels and white goods. The PLI scheme aims at incentivizing companies to boost domestic manufacturing and attract large investments which ultimately help India in increasing export, reducing impact and generating employment.

There are peculiarities and differences in the PLI scheme applicable to each industry. For e.g., as per the scheme applicable to white goods, PLI incentive and eligibility criteria for air conditioners (ACs) – AC components (large investments) are as below:

Year	PLI @ of incremental sales	Minimum cumulative incremental investments (INR crores)	Minimum net incremental sales (INR crores)
2021-22	-	150	-
2022-23	6%	300	750
2023-24	6%	400	1,500
2024-25	5%	500	2,000
2025-26	5%	600	2,500
2026-27	4%	-	3,000

For availing PLI benefit, a company may make an investment in greenfield or brownfield projects. The company should also make an incremental investment in purchase/ production of plant and machinery, technical transfer fee, research, and development expenses, etc.

We understand that whilst conditions related to incremental investment and incremental sales have been prescribed for most sectors, the exact quantum, incentives, and certain conditions vary, depending upon the underlying sector, type of product and fulfilment of criteria. Each eligible entity desirous of availing an incentive under the PLI scheme needs to evaluate its compliance based on specific notification, guidelines and other requirements prescribed by the government.

From an accounting perspective, PLI incentive meets the definition of a government grant under Indian Accounting Standard (Ind AS 20) Accounting for Government Grants and Disclosure of Government Assistance and, therefore, is treated as such.

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.

Recognition criteria

As per paragraph 8 of Ind AS 20, government grants, including non-monetary grants at fair value, shall not be recognized until there is reasonable assurance that the entity will comply with the conditions attaching to them, and the grant will be received.

The evaluation of whether and when an entity meets the recognition criteria under Ind AS 20 requires exercise of judgment based on the requirements of the scheme and entity specific facts, including but not limited to progress on the application made by the entity, its ability to meet prescribed criteria as well as additional requirements, if any, laid by the approving authority, interpretation issues involved and others. The entity should start applying government grant accounting only if it can demonstrate its ability to meet prescribed requirements for receiving incentive under the PLI scheme.

If the recognition criteria is met, certain peculiar issues might arise in applying the principles under Ind AS 20. This article looks at those issues and possible views. In preparing this article, whilst the PLI Scheme applicable to white goods has been referred to, we believe that similar consideration would apply in other cases as well.

Asset related grant vs. income related grant

As per paragraph 3 of Ind AS 20, grants related to assets are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire long-term assets, and grants which are not the asset related grant are considered as income related grants.

Considering the nature of the grant and the fact that the PLI scheme contains conditions both related to incremental investment and incremental sales, one may argue the following views on this matter.

View 1: PLI scheme is an asset related grant

One may argue that incremental investment / acquisition of asset is the primary eligibility condition because, without making incremental investment, the grant would not be received. Therefore, the condition relating to the acquisition of asset is a primary condition. Incremental sales are the result of the investment made by an entity and hence, consequent incremental sales are only an incidental condition. Thus, PLI is an asset related grant.

View 2: PLI is a grant related to income

The PLI scheme specifies two conditions for entities to become eligible for such a grant, i.e., incremental investment and incremental sales. One may argue that whilst it is true that without acquisition of the assets, the eligible criteria will not commence, however, it can only be completed after the entity is able to achieve incremental sales. Thus, incremental sale is a primary condition, and hence it is an income related grant. This view can be supported by the following further arguments:

- The amount of grant is determined as a percentage of incremental sales, thereby suggesting that incremental sale is a very important condition.
- The PLI scheme is aimed at helping companies achieve better performance. It is intended to ensure level playing field for Indian companies by compensating them for challenges faced resulting from higher operating costs and thereby enabling companies to price their product in a more competitive manner.
- Even without the PLI scheme, entities can make investments; however, without appropriate support for their operating margin, practically it is not economically viable for entities to make such investments.

View 3: PLI is a combination of asset related and income related grant

As per paragraph 19 of Ind AS 20, it may be appropriate to allocate part of a grant on one basis and part on another in cases where grants are received as part of a package of financial or fiscal aids. Care is needed in identifying the conditions giving rise to costs and expenses which determine the periods over which the grant will be earned.

Considering paragraph 19 and the fact that entities need to satisfy both conditions related to incremental investments as well as they have to carry out incremental sales, one may argue that it has elements of both asset related grant and income related grant. Hence, the grant should be split between these two components on an appropriate basis.

Based on discussion above, we believe that there are arguments in favor of applying either View 1 or View 2. Whilst View 3 has some merit, no reasonable basis exists for splitting the grant between the two components and it will involve an arbitrary allocation of the grant. In the absence of a clear basis, risks associated with arbitrary allocation are likely to exceed potential benefits. Hence, view 3 may not be applied in practice. It is pertinent to note that the classification of the grant as related to an asset or to income will require exercise of judgement and careful examination of the facts, objectives, and conditions attached to the scheme. The purpose of the grant and the costs for which the grant is intended to compensate would also be required to be ascertained carefully.

PLI incentive considered as an asset related grant - subsequent accounting treatment

As per paragraphs 24 and 29 of Ind AS 20, grants related to assets should be presented in the balance sheet either by setting up the grant as deferred income or by deducting the grant in arriving at the carrying amount of the asset and grants related to income are presented as part of profit or loss, either separately or under a general heading such as 'Other income'. Alternatively, income related grants can be deducted from the related expense presented in the financial statements.

Considering the above guidance, the following options exist on the matter:

- PLI grant is reduced from the carrying of the respective assets. This will automatically result in recognition of grant income over the useful life of the asset through reduced depreciation.
- PLI grant is treated as deferred income to be presented as a liability in the balance sheet. Such deferred income is recognized in profit or loss on a systematic basis over the useful life of the asset. Under this option, there are below two options with regard to presentation of grant amortization in profit or loss:
  - As reduction from depreciation expense on the relevant asset, or
  - Under general heading such as 'Other income'

If an entity opts to include the grant amortization under 'Other income', a related questing arises whether such amortization should be presented as 'Other income' only or it can also be presented as 'Other operating revenue.' This issue is not specifically addressed in authoritative guidance. We believe that one may make below key arguments to support 'Other operating revenue' presentation:

- Ind AS 20 has in-built flexibility with regard to presentation of government grant and presentation as 'Other income' is only an example. The overarching principle is that such a grant cannot be clubbed with the revenue from contracts with customers. The entity considers this aspect and other factors such as nature of grant, cost the grant is intending to compensate, linkage with operating activities, and decides an appropriate heading under which grant is presented. Since grant is closely related to operating activities and intends to compensate for higher operating costs / lower revenue, it can be argued that the grant arises from the company's operating activities and should be presented as 'Other operating revenue.'

- Recognition of grant under Ind AS 20 is based on the key principle that it is matched with related activity/ income/ expense. It may be argued that the said principle is also maintained regarding the presentation of grants.
- The Guidance Note on Ind AS Schedule III provides the following guidance with regard to 'Other operating revenue'.

"9.1.8. The term 'other operating revenue' is not defined. This would include revenue arising from a company's operating activities, i.e., either its principal or ancillary revenue-generating activities, but which is not revenue arising from sale of products or rendering of services. Whether a particular income constitutes 'other operating revenue' or 'other income' is to be decided based on the facts of each case and detailed understanding of the company's activities."

PLI as an income related grant - subsequent accounting treatment

Attention is drawn to paragraphs 12 and 29 of Ind AS 20, income related grants should be recognized in profit or loss on a systematic basis over the periods in which the entity recognizes the related expenses and it could be presented either separately or under a general heading such as 'Other income' in the profit and loss. Alternatively, income related grants can be deducted from the related expense presented in the profit and loss.

In the context of PLI, it may be difficult to identify any specific expense which the grant is intended to compensate. In the absence of any other criteria, one may argue that the entity is incurring overall expenses in terms of higher production cost and the same are being compensated through PLI incentive. Hence, PLI grant income is recognized in the profit or loss based on actual/ estimated sales during the year.

Regarding presentation in profit or loss, attention is drawn to guidance under the previous issue relating to subsequent accounting treatment of a PLI incentive considered as an asset related grant. Considering similar arguments, one may take a view that the amount can be presented under the head 'Other operating revenue/ Other income'.

Accounting in the quarterly results and annual financial statements

Ind AS 34 Interim Financial Reporting provides as below:

"37. Revenues that are received seasonally, cyclically, or occasionally within a financial year shall not be anticipated or deferred as of an interim date if anticipation or deferral would not be appropriate at the end of the entity's financial year.

38. Examples include dividend revenue, royalties, and government grants. Additionally, some entities consistently earn more revenues in certain interim periods of a financial year than in other interim periods, for example, seasonal revenues of retailers. Such revenues are recognized when they occur."

Based on the above, at each reporting date including at the end of each quarter, an entity will need to assess and exercise judgement whether grant conditions are expected to be met. If the assessment indicates that there is a reasonable assurance that the condition will be met and the company will become eligible for the grant, recognition will be made on the same basis as that used for year-end financial statements in the quarterly results as well.

How we look at it

The recognition and presentation of the grant received by entities under the PLI scheme may vary industry to industry as conditions attached to the qualifying criteria and subsequent disbursal could be different across industries. This would need a careful assessment and exercise of judgement after careful examination of facts of the scheme for the respective industries.

Considering that incentive will be provided to the entities for the number of years after it becomes eligible to receive them, the assessment will have to be revisited to identify if there is any change in the fact pattern and whether the treatment evaluated for the recognition and presentation of the grant in the balance sheet or profit and loss at the time of receiving the grant continue to be appropriate in the subsequent periods.

Our 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, O'Shaughnessy Road
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
Golf View Corporate Tower B
Sector 42, Sector Road
Gurugram - 122 002
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
Gautam Budh Nagar, U.P.
Noida - 201 304
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, Shantiniketan Building
Holding No. 1, SB Shop Area
Bistupur, Jamshedpur – 831 001
Tel: + 91 657 663 1000

Kochi
9th Floor, ABAD Nucleus
NH-49, Maradu PO
Kochi - 682 304
Tel: + 91 484 433 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.

EYIN2304-017
ED None

GA