Comments on Exposure Draft of Ind AS Compliant Schedule III to the Companies Act, 2013, for Non-Banking Financial Companies (NBFCs)

1. Paragraph 5 of General Instructions for Preparation of Financial Statements of a Non-Banking Financial Company (NBFC) in the Exposure Draft under consideration states the following below the table specifying rounding off limits:

   "*Once a unit of measurement is used, it should be used uniformly in the Financial Statements*"

   The used of the word "should" dilutes the authority of the requirement from mandatory to recommendatory. It is recommended that the word "should" be replaced with "shall".

2. Paragraph 6 of General Instructions for Preparation of Financial Statements of a Non-Banking Financial Company (NBFC) in the Exposure Draft under consideration states the following:

   "*Financial Statements shall contain the corresponding amounts (comparatives) for the immediately preceding reporting period for all items shown in the Financial Statements including Notes except in the case of first Financial Statement laid before the NBFC after incorporation*"

   There are two issues with the above paragraph:

   a. The use of the words "corresponding figures (comparatives)"; and

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b. The use of the words "NBFC"

a. Use of the words "corresponding figures (comparatives)":

The use of the words "Corresponding Figures" is in line with the Division I of Schedule III that is applicable to Accounting Standards. It may be noted that the same has been used in Division II of Schedule III which is not proper. Given below are the reasons for our view:

i. Attention is drawn to Explanation 2 of sub-rule (1) of Rule 4 of the Companies (Indian Accounting Standards) Rules, 2015 which states as under:

"*Comparatives shall mean comparative figures for the preceding accounting period".*

Thus, the comparatives are not corresponding figures but comparative figures. Therefore, the use of the words "corresponding figures" creates a conflict with the rules which can impair compliance with law uniformly.

ii. The use of the words "corresponding figures" dilutes the status of the comparative information and is misleading. This misleading use of words is evidenced by the Implementation Guide on Auditor's Report under Ind AS for Transition Phase issued by the Auditing and Assurance Standards Board of The Institute of Chartered Accountants of India. Paragraph 10 of the Implementation Guide refers to paragraph 6 of the 'General Instructions for the preparation of Financial Statements of a

Company Required to Comply with Ind AS' in Schedule III to the Companies Act, 2013 and SEBI Listing Regulations which use the words "corresponding amounts" or "corresponding figures" and thereby concludes that the financial reporting frameworks in India use the corresponding figures approach for general purpose financial statements. Paragraph 12, based on the discussion in paragraphs 9 to 11, concludes that the audit report on the financial statements / financial results prepared in conformity with Ind AS would also be based on the corresponding figures approach. As no comments were invited before issuing the implementation guide and this being an opportunity to comment on the same, given below are our comments on the use of the words "corresponding figures" in Implementation Guide:

i. To substantiate its conclusion in paragraph 10, the Guide discusses very briefly on the retrospective application and retrospective restatement requirement under Ind AS 8. The Guide reproduces the requirements specified in paragraph 22 of Ind AS 8 by smartly replacing the words "comparative amounts" specified in paragraph 22 of Ind AS 8 with the words "corresponding figures" to substantiate its conclusion in paragraph 10 and stating that such retrospective application or retrospective restatement requirement does not necessitate use of comparative financial statements framework for reporting purposes. The author is unable to understand the necessity to replace the words "comparative amounts" with "corresponding figures".

ii. In this regard, reference is drawn to paragraph BC7 of the Basis for Conclusions on IAS 8 where the reason to require retrospective application is stated. Paragraph BC7(b) states, inter alia, that information presented about prior periods is prepared on the same basis as information about the current period, and is therefore comparable. If we were to read this reason with the last sentence of the definition of comparative financial statements specified in SA 710, we get a hint that IFRS and therefore, Ind AS, specify comparative financial statements approach to be followed and not the corresponding figures approach.

iii. There is no standard on presentation of financial statements under Companies (Accounting Standards) Rules, 2006. Therefore, the presentation of financial statements under Accounting Standards framework was governed by the provisions of Revised Schedule VI under Companies Act, 1956 and now by Division I of Schedule III under Companies Act, 2013. Thus, it can be concluded from Division I of Schedule III that the approach followed is corresponding figures approach. However, under Ind AS, there is a standard on presentation of financial

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statements. Paragraph 2 of the General Instructions referred to by the Implementation Guide provides:

Where compliance with the requirements of the Act including Indian Accounting Standards (except the option of presenting assets and liabilities in the order of liquidity as provided by the relevant Ind AS) as applicable to the companies require any change in treatment or disclosure including addition, amendment, substitution or deletion in the head / sub-head or any changes inter se, in the financial statements or statements forming part thereof, the same shall be made and the requirements of the schedule shall stand modified accordingly.

Thus, under Ind AS, the requirements for presentation of financial statements contained in Ind AS will override the requirements of Division II of Schedule III to the Companies Act, 2013. Paragraphs 38 to 38D of Ind AS 1, *Presentation of Financial Statements,* contain the provisions regarding comparative information. Paragraph 38 requires presentation of comparative information for all amounts reported in the current period. Paragraphs 38A and 38B require one year comparatives as minimum. The question is whether the minimum comparative information required can be said to be corresponding figures or comparative financial statements. Paragraph

38C of Ind AS 1 clarifies this by stating that an entity may present comparative information in addition to the **minimum comparative financial statements** required by Ind AS. Thus, paragraph 38C clarifies that the minimum comparative information is not just corresponding figures but comparative financial statements.

iv. The very requirement of Ind AS 101 to start accounting under Ind AS 101 from the beginning of the earliest period for which an entity presents full comparative information under Ind AS in first Ind AS financial statements emphasizes the fact that the comparative information is not just 'corresponding figures' but is in fact 'comparative financial statements'.

b. Use of the word "NBFC":

There could be a case where a company is incorporated as other than NBFC and after some years is converted into an NBFC. Thus, the NBFC will lay its first financial statements after incorporation. However, that financial year is not the first year after incorporation. Hence, the company was in existence in previous years for which financial statements would be available. Therefore, the word "NBFC" should be replaced by "company".

3. The Statement of Changes in Equity does not specify the line items required by paragraph 106 of Ind AS 1. The same is the situation in Division II of Schedule III and this could result in many companies not presenting as per Ind AS 1.

4. In page 27: (P) Other Financial Liabilities (to be specified) requires presentation of Interest accrued and due and Interest accrued but not due. It may be noted that paragraph 4.2.1 of Ind AS 109 *Financial Instruments* requires all financial liabilities to be subsequently measured at amortised cost except in four cases which are thought to be applicable to a few. The amortised cost of a liability / asset includes the principal and interest. Further the interest is on effective interest method. Therefore, requiring presentation of interest and principal component separately would make the presentation non-compliant with Ind AS 109 as neither the carrying amount shown under borrowings will be amortised cost nor the interest will be amortised cost. The concepts of interest accrued and due and interest accrued and not due are applicable when the interest is on contractual basis. Under Ind AS, the interest is calculated on effective interest method. Under effective interest method, the total interest for the period could be Rs.135 which on contractual basis could be Rs.100. In this scenario, one may arrive at interest accrued and due and interest accrued but not due on the basis of Rs.100 but what about the difference of Rs.135 and Rs.100. Is it interest accrued but not due? It may be noted that under effective interest method, the transaction costs are also included in interest which are

already paid and thus not due. Therefore, the entire difference of Rs.35 (Rs.135 – Rs.100) is not interest accrued but not due. Thus, under effective interest method, it could be highly impracticable to present separately interest accrued and due and interest accrued but not due. Further, any separate presentation of principal and interest component could invite non-compliance with Ind AS 109. Further, the ICAI should provide a guidance on the presentation policy to be specified for such separate presentation as the presented amounts will not be amortised cost.

5. Paragraph 79(b) of Ind AS 1 requires disclosure of nature and purpose of each reserve within equity. However, the exposure draft requires disclosure of nature and amount of each item within other equity. The same needs change in Division II of Schedule III. Either this requirement should be in line with Ind AS 1 or should not be there so that the same may be disclosed as per the requirement of Ind AS 1. The requirement of disclosing only the nature of each item within other equity may result in non-compliance with Ind AS.

6. Note (U)(i)(b) in Page 29 of the Exposure Draft requires Guarantees to be disclosed under Contingent Liabilities. Below the note of Contingent Liabilities, the exposure draft provides guidance on disclosure of financial guarantees as contingent liabilities which would be the gross amount of the financial guarantee as reduced by the amount recognised in the balance sheet for the same. Attention is drawn to paragraph 2 of

Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets* which states as under:

"2 This Standard does not apply to financial instruments (including guarantees) that are within the scope of Ind AS 109, Financial Instruments."

Thus, disclosure of financial guarantees under Contingent Liabilities may result in non-compliance of Ind AS 37.

Under Ind AS, financial guarantees are recognised, measured and presented on balance sheet. Paragraph 4.2.1(c) of Ind AS 109 states the following with regard to subsequent measurement of financial guarantee:

"4.2.1 (c) financial guarantee contracts. After initial recognition, an issuer of such a contract shall (unless paragraph 4.2.1(a) or (b) applies) subsequently measure it at the higher of:

(i) The amount of the loss allowance determined in accordance with Section 5.5; and

(ii) The amount initially recognised (see paragraph 5.1.1) less, when appropriate, the cumulative amount of income recognised in accordance with the principles of Ind AS 18."

Appendix A of Ind AS 109 provides the following definitions:

"Loss Allowance The allowance for expected credit losses on financial assets measured in accordance with paragraph 4.1.2, lease receivables and contract assets, the accumulated impairment amount for financial assets measured in accordance with paragraph 4.1.2A and

the provision for expected credit losses on loan commitments and financial guarantees.

Expected Credit Losses The weighted average of credit losses with the respective risks of a default occurring as the weights."

Therefore, the measurement of the financial guarantee itself takes care of expected losses and no further amount of financial guarantee liability needs to be disclosed because:

(i) Such a disclosure is beyond the scope of Ind AS 37; and

(ii) Any amount disclosed over and above the amount recognised will be remote and on application of the principles enunciated in Ind AS 37, should not be disclosed.

7. Note (V) in Page 30 of the Exposure Draft requires Arrears of fixed cumulative dividends on irredeemable preference shares to be disclosed separately. It may be noted that fixed cumulative dividends on irredeemable preference shares form the liability component of compound financial instrument. Therefore, the fixed cumulative dividend would be recognised as interest in the Statement of Profit and Loss on Effective Interest Method. Further, any arrears would invite the disclosures relating to defaults and breaches contained in Ind AS 107, *Financial Instruments: Disclosures.* Hence, this requirement should be removed from Schedule III. If such requirement is to be retained, the requirement should be made applicable to defaults on interest relating to any compound financial instrument.

8. The Statement of Profit and Loss requires the items of Other Comprehensive Income to be disclosed as under:
    a. Items that will not be reclassified to profit or loss
    b. Items that will be reclassified to profit or loss

   Attention is drawn to the requirements of paragraph 82A of Ind AS 1, *Presentation of Financial Statements* which states as under:

   "82A The other comprehensive income section shall present line items for amounts of other comprehensive income in the period, classified by nature (including share of the other comprehensive income of associates and joint ventures accounted for using the equity method) and grouped into those that, in accordance with other Ind ASs:
    a. Will not be reclassified subsequently to profit or loss; and
    b. Will be reclassified subsequently to profit or loss when specific conditions are met."

   It can be seen from the above that the requirement is to show items of OCI that will be reclassified subsequently to profit or loss **when specific conditions are met**. Thus, paragraph 82b means items that may be reclassified to profit or loss. Let us understand the implications of using the word "will" instead of "may". Paragraph 7 of Ind AS 1 lists 9 items of OCI of which 4 items will not be reclassified to profit or loss, 2 items will be reclassified on derecognition and 3 items may be reclassified if the hedge item is a financial asset / financial liability. By requiring the bifurcation of items of OCI into items that will be reclassified and that will not be reclassified would require entities to further bifurcate the 3 amounts that may be reclassified into that will be reclassified and that will not be reclassified without any further benefits from such additional exercise.

Therefore, it is requested that the classification of items of other comprehensive income be changed to:

a. *Items that will not be reclassified to profit or loss*
b. *Items that may be reclassified to profit or loss*

9. Note 3 of General Instructions for preparation of Statement of Profit and Loss in Page 35 on Interest Income requires interest income to be disaggregated into:
   a. On financial assets measured at fair value through OCI
   b. On financial assets measured at amortised cost
   c. *Interest income on securities classified at fair value through profit or loss*

   Given below are our observations in this regard:
   a. The words "Interest income" in the fourth and seventh column should be deleted
   b. Presenting income separately from fair value changes for assets classified as FVPL would mean that the entity recognise interest on dual basis, effective interest method for financial assets classified and measured at amortised cost and at fair value through other comprehensive income in accordance with paragraph 4.1.2A of Ind AS 109 and coupon basis or the unwinding effect for financial assets measured at fair value through profit or loss. Such multiple basis of

recognition, measurement and presentation of interest income will not be in accordance with Ind AS 109 which requires measurement of interest on effective interest method only.

c. Ind AS 109 requires dual measurement basis to be followed for financial assets measured at fair value through OCI in accordance with paragraph 4.1.2A. The fair value change that is recognised in OCI is the dirty fair value price excluding interest which is recognised on effective interest method. For financial assets measured at Fair Value through Profit or Loss, the fair value change is clean fair value change. Bifurcating interest and other fair value changes would mean that neither the interest is recognised and presented on effective interest method nor the fair value change represents clean fair value change.

d. Requiring interest to be separately presented from total fair value change would bring in unnecessary complications that could make financial statement non-compliant with Ind AS rather than enhance compliance with Ind AS. This is illustrated below.

Assume X Ltd. has a loan that has determined amount of cash flows but not on specified dates. Therefore, X Ltd. is required to classify and measure the loan at Fair value through profit or loss.

Period	Cash Flows	Discount Rate @10%	Present Value
1	0	0.909091	0
2	0	0.826446	0
3	0	0.751315	0

4	0	0.683013	0
5	10000	0.620921	6209.213
Fair value of loan on intital recognition			**6209.213**

Period	Cash Flows	Discount Rate @9	Present Value
2	0	0.917431	0
3	0	0.84168	0
4	0	0.772183	0
5	10000	0.708425	7084.252
Fair value of loan on subsequent measurement			**7084.252**

Total clean fair value change	875.0389
Interest income	620.9213
Dirty fair value change	254.1176

Therefore, as can be seen from above table, if interest is bifurcated from fair value, fair value gain would be reported as Rs.254.12 rather than Rs.875.04 Presenting interest income when the entity manages the financial assets on fair value basis would make the financial statements irrelevant to the users.

e. If interest is required to be shown separately then separate presentation of interest should also be required for financial asset designated as at fair value through profit or loss.

10. The above arguments also apply in case of Note 6 on Finance Costs. Therefore, separation of interest and fair value change should not be required in disaggregation of line items presented on face. The said information may be required by way of additional notes.

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