ACCOUNTING AND COMPANY LAW

N. A. SHAH BULLETIN

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Chartered Accountants

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EXECUTIVE SUMMARY

- **Accounting**

  - The Institute of Chartered Accountants of India (ICAI) has issued an expert advisory opinion on (a) Whether capital reserve can be considered for calculation of net worth of a company (b) Accounting treatment of base stock and valuation of inventory booked by the customers.

    (a) As per the opinion, Committee is of the view that purely from accounting perspective, net worth should include capital reserve in view of definition of net worth & net assets as per 'Guidance Note on Terms Used in Financial Statements'. However, Committee has not examined this issue from legal perspective such as interpretation of terms of Request For Qualification (RFQ) for Tender or Companies Act, 2013 ('the Act').

    (b) The base stock of silver (raw material) is an inventory as per Accounting Standard 2 and cannot be considered and recognized as a 'property, plant and equipment' and therefore, the same should be valued at cost or net realizable value, whichever is lower. Further, silver booked by the customers in advance should not be valued at the rate at which the same is booked by the customers. In this case also, valuation of inventories has to be at lower of cost or net realisable value and the rate at which customer has booked the silver has to be referred for the purpose of net realisable value.

- **Company Law**

  - As per the amendment in Companies (Acceptance of Deposits) Rules, 2014, specified IFSC public companies also can now accept deposits from members upto 100 % of share capital, reserves and securities premium. Private company which is a start-up company, for five years from the date of its incorporation and private company which satisfies the prescribed conditions can accept deposits from its members without any limit.

  - For the purpose of exemption from appointment of independent directors in unlisted public company, meaning of term "Joint Venture" is clarified by MCA.

  - MCA has issued Companies (Restriction on number of layers) Rules, 2017 prescribing the applicability, exemptions and other procedural aspects.

  - Certain powers of Serious Fraud Investigation Officer as prescribed in subsection 8, 9 and 10 are effective from 24th August 2017.

- **Indian Accounting Standards (Ind AS)**
  - Clarifications have been issued by Ind AS Transition Facilitation Group (ITFG) vide its bulletin no. 11 on 31st July 2017.
  - MCA has issued clarification in respect of obligation to comply with the Indian Accounting Standard (Ind AS) and Rule 4 of the Companies (Indian Accounting Standard) Rules, 2015 by Payment Banks, Small Finance Banks which are subsidiaries of Corporates.

1. Accounting

1.1 Expert Advisory Opinion- August 2017

Considering capital reserve for calculation of net worth of the Company.

a. Facts of the case

- In respect of selection of Mine Developer cum Operator (MDO) for coal block of the company (querist) , A Ltd. submitted a bid in consortium with B Ltd. against the 'Request for Qualification (RFQ) for Tender' issued by the querist.

- In this connection, A Ltd. filed its net worth certificate based on audited financials of 31st March, 2015. A Ltd. considered capital reserve as part of net worth on the premise that capital reserve was on account of write back of creditors liability pursuant to Deed of Company Arrangement as per section 439A of the Companies Act.

- As per the querist, the 'net worth' is not supposed to include any reserves arising on account of amalgamation, etc. considering the definition of 'net worth' given in RFQ and Companies Act, 2013 and it is supposed to include reserves created out of profits only. Besides, the RFQ requires 'net worth' criteria to be fulfilled so as to ascertain strength of the participants. If such 'net worth' would include claims written back, it does not portray strength of A Ltd. but its execution weakness.

- As per the querist, this write back is accounted as 'Other Comprehensive Income' and then transferred to 'Capital Reserves'. Had it been on revenue account, it should have been accounted as normal profit and loss and should have formed part of 'reserves' and not 'capital reserves'. Hence, such 'capital reserves' should be excluded from computation of 'net worth'. Further, there are concerns over going concern of A Ltd. on standalone basis and even at consolidated level, there is a negative net worth.

b. Query

- Considering the above-mentioned facts and as per definition of net worth provided in RFQ document in the opinion of the querist, net worth of A Ltd. for the financial year ended 31st March, 2015 is negative. In view of the above, whether contention of not considering capital reserve (created as above) for calculation of net worth of A Ltd. is appropriate in the light of

Indian Generally Accepted Accounting Principles (GAAPs) and accounting concepts.

c. Points considered by the Committee

- The Committee points out that the opinion expressed is purely from the perspective of accounting principles, viz., Indian GAAPs and not from legal perspective, such as, interpretation of the terms of RFQ for Tender or Indian Companies Act, 2013, etc. or bidding perspective.

- Committee notes the definition of Net Assets and Net Worth from the 'Guidance Note on Terms Used in Financial Statements', issued by the Institute of Chartered Accountants of India (ICAI). Net Assets is the excess of the book value of assets (other than fictitious assets) of an enterprise over its liabilities. This is also referred to as net worth or shareholders' funds. It does not exclude any kind of reserve–capital reserve or reserve created out of restructuring/ amalgamation. Accordingly, the Committee is of the view that purely from accounting perspective, net worth includes all reserves, whether capital or revenue.

- Whether a particular item (for example, capital reserve) is to be included or not in net worth would depend on the purpose for which such net worth is being computed, for instance, from the Companies Act, 2013 perspective, some specific reserves are excluded from the definition of net worth. Similarly, for bidding purposes, the net worth may be defined by an entity considering the purpose for which it is to be used.

d. Opinion

- On the basis of the above and without examining the issue from legal perspective, such as, interpretation of the terms of RFQ for Tender or Indian Companies Act, 2013, etc., as above, the Committee is of the view that purely from accounting perspective, net worth should include capital reserve.

1.2 Expert Advisory Opinion- September 2017

Accounting Treatment of Base Stock; and valuation of Inventory booked by the customers

a. Facts of the case

- A company is engaged in manufacturing of contract material made of silver and silver alloy. Silver is a basic raw-material. There are 20 to 30 operations to make components of silver or silver alloy right from melting to finished product.

- According to the querist, on an average, out of total stock of 7,500 kg. of silver in stock, 3,500 kg. silver always remains on the shop floor. It is fixed stock remaining on the shop floor at all the time and it remains as a permanent inventory.

- Further, the querist has stated that silver price is fluctuating and hence, few customers of the company book silver in advance at an agreed price. After the customer fixes the silver prices, the company buys silver depending upon the availability of silver in the market. Thus, the company's purchase price may vary because of fluctuation in market but for all purposes, the customer's price is fixed. Whenever the finished product is ready, the company bills such customer based on the silver price booked by them plus other material and manufacturing costs.

- Accounting policy for inventory valuation of the company inter alia states that silver booked by customers for their process work has been valued at the rates at which the same is booked by them otherwise it is valued at lower of cost or net realisable prices.

- Due to wide fluctuation in the silver price, there is significant impact on the valuation of inventories. The business performance is never reflected properly and is heavily influenced by this fluctuation in silver price. Further, it affects the balance sheet every quarter positively and negatively.

b. Query

(i) Whether silver booked by the customer for their process work can be valued at the rate at which the same is booked by them. (ii) Whether the company should value raw material, i.e., base stock of 3,500 kg. of silver at cost which will remain unchanged instead of present valuation of lower of cost and net realisable value or Whether 3,500 kg. of silver which normally remains in cycle of production can be considered as part of plant and machinery and capitalised instead of present valuation of lower of cost and net realisable value.

c. **Points considered by the Committee**

- Based on the definition of the term 'inventories' as given in Accounting Standard (AS) 2, 'Valuation of Inventories' and the definition of the term 'property, plant and equipment' as given in Accounting Standard (AS) 10 (Revised), 'Property, Plant and Equipment', committee notes that classification of an asset as a 'property, plant and equipment' or inventory depends on its intended primary use for an entity.

- If an asset is essentially held for using it for the purpose of producing or providing goods or services rather than for sale in the normal course of business, it is classified as 'property, plant and equipment'. However, if it is held for sale in the ordinary course of business, or if it is used in the process of production for such sale; or in the form of materials or supplies to be consumed in the production process or in the rendering of services, the asset should be classified as inventory.

- The Committee notes from the facts of the case that although the base stock of silver of 3,500 kg. may be essential at all times for uninterrupted production, however, the stock is intended to be used in the process of production for sale of finished goods. Composition of such stock would keep on changing as there would be inflow of new silver stock purchased and outflow of silver issued for further processing. Further, the fixed quantity of stock is not maintained due to any technological requirement of any plant and machinery; rather seems to be due to administrative convenience so that the inventory of silver is always available for use in production process. Accordingly, the Committee is of the view that the base stock of silver is an inventory as per AS 2.

- With regard to the valuation of inventory of silver booked by the customers in advance, the Committee notes that based on the para 24 of AS 2, the materials held for use in the production process should normally be valued at cost unless (i) there has been a decline in the price of materials, and (ii) it is estimated that the cost of the finished product will exceed its net realisable value. If these two conditions are fulfilled, then the materials held should be valued at net realisable value.

- In the present case, valuation of the silver booked by the customers in advance is done at booked price of silver plus the related cost attached to that stage. It is noted that the prices at which the silver is booked by the customer would generally be different from the prices at which the same is purchased by the company. Thus, the Committee is of the view that the aforementioned principle of valuation of materials held for use in the production process is not being followed by the Company. Accordingly, the same is not appropriate and in accordance with the requirements of AS 2. The value at which the stock of silver is booked by the customer would be relevant only for determination of net realisable value of the silver or its finished product.

e. Opinion

- The base stock of silver is an inventory as per AS 2 and cannot be considered and recognised as a 'property, plant and equipment' and therefore, the same should be valued at cost or net realisable value, whichever is lower.

- The silver booked by the customer for their process work should not be valued at the rate at which the same is booked by them. It has to be valued at lower of cost or net realisable value.

2. Company Law

2.1 Relaxations in prohibitions on acceptance of deposits from members

Summary of amendments to Companies (Acceptance of Deposits) Rules, 2014 is as under:

a. Specified International Financial Service Centre (IFSC) public company may accept deposits from members upto 100% of aggregate of the paid up share capital, free reserves and securities premium account. Details of deposits accepted are required to be submitted to the RoC in Form DPT-3.

b. Following companies can accept deposits from its members without any limit. Details of deposits are required to be filed in Form DPT-3 with the RoC.

   - Private company which is a start-up, for five years from the date of its incorporation;

   - Private company which fulfills all of the following conditions :
     i. which is not an associate or a subsidiary company of any other company;
     ii. the borrowings of such a company from banks or financial institutions or any body-corporate is less than twice of its paid up share capital or fifty crore rupees, whichever is less ; and
     iii. such a company has not defaulted in the repayment of such borrowings subsisting at the time of accepting deposits under section 73.

c. Revised Form DPT 3 has been introduced which is available for e-filing after the month of November 2017.

2.2 Meaning of term "Joint Venture"

As per Companies (Appointment and Qualification of Directors) Rules, 2014, unlisted public company which is a joint venture, a wholly owned subsidiary or a dormant company is not required to appoint Independent Directors. Clarifications was sought with regard to the meaning of joint venture for the purposes of availing exemption under Rule 4 of the aforesaid Rules as such a term is not defined in Act.

MCA vide its circular has now clarified that "Joint Venture" would mean a joint arrangement, entered into in writing, whereby the parties that have joint control of the arrangement, have rights to the net assets of the arrangement. The usage of the term is similar to that under the Accounting Standards.

2.3 Restriction on number of layers of subsidiaries

- **Summary of provisions of Companies (Restriction on number of layers) Rules, 2017 are as under:**

  a. No company shall have more than two layers of subsidiaries except;
     (a) banking company
     (b) non-banking financial company (nothing specified in relation to housing finance companies/ NBFC CICs)
     (c) insurance company
     (d) government company

  b. Provisions of these rules shall not affect a company from acquiring a company incorporated outside India with subsidiaries beyond two layers as per the laws of such country.

  c. For the purpose of computing the number of layers under this rule, one layer which consists of one or more wholly owned subsidiary or subsidiaries shall not be taken into account.

  d. The provisions of this rules shall not be in derogation of the proviso to sub-section (1) of section 186 of the Act which specifies exemptions from the restrictions on layers.

  e. Existing companies which had number of layers more than two layers, shall comply with the following requirements:

     i. It shall file, with the RoC, a return in Form CRL-1 (new E-form) within a period of 150 days from the date of publication of these rules in the Official Gazette;
     ii. It shall not, after commencement of these rules, have any additional layer of subsidiaries and
     iii. It shall not, in case one or more layers are reduced by it subsequent to the commencement of these rules, have any additional layer.

  f. In case of contravention, the company and every officer of the company who is in default shall be punishable with fine which may extend to Rs. 10,000 and in case of continuing contravention, with a further fine which may extend to Rs. 1,000 for every day after the first during which such contravention continues.

- **Enactment of the proviso to the definition of subsidiary**
  Proviso to the definition of “Subsidiary” in respect of restriction on number of layers to prescribed class of companies is effective from 20th September, 2017.

3. Indian Accounting Standards

3.1 ITFG Bulletin 11

Issue No.	Issues and Answers
1.	Whether ESOP reserve is required to be included while computing net worth of a company to assess applicability of Ind AS on the company?
	a) As per the definition in Rule 2(1)(f) of Companies (Indian Accounting Standards) Rules, 2015, "net worth" shall have the meaning assigned to it as in clause (57) of section 2 of the Act. b) As per the Guidance Note on Accounting for Employee Share-based Payments which, inter alia, 'Stock Options Outstanding Account' is transitional in nature as it gets ultimately transferred to another equity account such as share capital, securities premium account and/or general reserve, as applicable. c) In view of the above, ESOP reserve is required to be included while computing net worth of a company to while calculating the net worth for applicability of Ind AS. d) This clarification is only for the purpose of Ind AS applicability and should not be applied by analogy for determining net worth under other provisions of the Companies Act, 2013.
2.	Deferred Taxes in the situations of Tax Holiday under Sections 80-IA and 80-IB of the Income-tax Act, 1961
	a) ASI 3 and ASI 6 gave the guidance on deferred taxes in the situations of Tax Holiday. Similar explanation is not available under Ind AS 12. However, paragraph 47 of Ind AS 12 states that deferred tax assets and liabilities shall be measured at the tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. b) Accordingly, the deferred tax in respect of temporary differences which reverse during the tax holiday period shall not be recognized to the extent the entity's gross total income is subject to the deduction during the tax holiday period as per the requirements of section 80IA/80IB of the Income Tax Act, 1961.
3.	Paragraph 9 of Ind AS 33, Earnings per Share states that, "An entity shall calculate basic earnings per share amounts for profit or loss attributable

	to ordinary equity holders of the parent entity and, if presented, profit or loss from continuing operations attributable to those equity holders." Should subsidiary company which is not wholly owned, present EPS only for the portion of the profit which is attributable to the parent entity?
	a) In accordance with paragraph 4 of Ind AS 33, entity is required to disclose EPS in both its Standalone financial statements (SFS) and in Consolidated Financial statements (CFS) (if presented by the entity). b) Further, paragraph A1 of Appendix A of Ind AS 33 also states that for the purpose of calculating earnings per share based on the consolidated financial statements, profit or loss attributable to the parent entity refers to profit or loss of the consolidated entity after adjusting for non- controlling interests. c) Though, the requirements of paragraph 9 of Ind AS 33 have been provided in the context of calculating EPS in the consolidated financial statements of an entity, analogy may be drawn that in case of separate financial statements, the parent entity mentioned in paragraph 9 will imply the legal entity of which separate financial statements are being prepared. Accordingly, when an entity presents EPS in its separate financial statements, then the same shall be calculated based on the profit or loss attributable to its equity shareholders.
4.	MNC Ltd is a first-time adopter of Ind AS. At the date of transition to Ind AS, it opted to measure its investment in subsidiary at deemed cost as per Ind AS 101, First-time Adoption of Indian Accounting Standards. Whether in its first Ind AS financial statements prepared as at the end of the reporting period, MNC Ltd. is required to measure its investment in subsidiary at cost only or it has the option to measure the investment as per Ind AS 109 in accordance with paragraph 10 of Ind AS 27?
	a) With reference of para D14 & D15 of Ind AS 101, deemed cost exemption under paragraph D15 is available to an entity when it chooses to measure the investment at cost in accordance with Ind AS 27. b) Paragraph 7 of Ind AS 101 states that, an entity shall use the same accounting policies in its opening Ind AS Balance Sheet and throughout all periods presented in its first Ind AS financial statements. c) Accordingly, if a company chooses to measure its investment in subsidiary at the date of transition at deemed cost measured as per paragraph D15, then it shall carry such investment at that amount (i.e. deemed cost as per paragraph D15) in its first Ind AS financial statements prepared as at the end of the reporting period.

	d) Further, if the entity has opted to measure the investments at deemed cost on the date of transition to Ind AS in its opening Ind AS balance sheet, then all subsequent investments made in that category should be measured at cost in accordance with Ind AS 27 in its financial statements prepared as at the end of the reporting period. However, for the investment made in different category (e.g. associate or joint venture), the entity has an option to account for those investments at cost or in accordance with Ind AS 109.
5.	MNC Ltd. has received grant in the nature of exemption of custom duty on capital goods with certain conditions related to export of goods under Export Promotion Capital Goods (EPCG) scheme of Government of India. Whether the same is a government grant under Ind AS 20, Government Grants and Disclosure of Government Assistance? If yes, then whether it is a Grant related to asset or Grant related to income and how the same is to be accounted for?
	a) As per para 3 of Ind AS 20, exemption of custom duty under EPCG scheme is a government grant and should be accounted for as per the provisions of Ind AS 20. b) The classification of the grant as related to asset or income requires exercise of judgement and careful examination of the facts, objective and conditions attached to the scheme of the government, the purpose of the grant and the costs for which the grant is intended to compensate. c) In the given case, if based on the terms and conditions of the scheme, the grant received is to compensate the import cost of assets subject to an export obligation as prescribed in the EPCG Scheme; recognition of grant in the statement of profit and loss should be linked to fulfilment of associated export obligations. d) However, if the grant received is to compensate the import cost of the asset and based on the examination of the terms and conditions of the grant, if it can be reasonably concluded that conditions relating to export of goods are subsidiary conditions, then it is appropriate to recognise such grant in profit or loss over the life of the underlying asset.
6.	If subsidiary is following SLM method of depreciation and holding company is following WDV method in its separate financial statements, whether depreciation on fixed assets of the subsidiary is to be realigned to WDV method?

	a) As per para 19 and B87 of Ind AS 110- Consolidated Financial Statements, an entity has to apply uniform accounting policies for like transactions and events in similar circumstances. It does not apply to accounting estimates made while preparing financial statements. b) Further, as per para 60 & 61 of Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors, the entity should select the method that most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. c) Therefore, there can be different methods of estimating depreciation for property, plant and equipment, if their expected pattern of consumption is different. The method once selected in the standalone financial statements of the subsidiary should not be changed while preparing the consolidated financial statements.
7.	If reporting entity is preparing the financial statements as per Ind AS and it has Investments in partnership firm, whether such firm is also required to prepare financials as per Ind AS.
	a) Non-corporate entities including partnership firms shall not prepare the financials as per Ind AS and standards of ICAI should be followed. They cannot be applied by non-corporate entities even voluntarily. However, in case a relevant regulator specifically provides for implementation of Ind AS, non-corporate entities shall apply Ind AS. b) However, for the purpose of consolidation, the partnership firm will be required to provide financial statements data prepared as per Ind AS to parent company provided the partnership qualifies as a subsidiary/joint venture/associate.
8.	ABC Ltd is setting up a new refinery outside the city limits. In order to facilitate the construction of the refinery and its operations, ABC Ltd. is required to incur expenditure on the construction/development of railway siding, road and bridge. Though ABC Ltd. incurs (or contributes to) the expenditure on the construction/development, it will not have ownership rights on these items and they are also available for use to other entities and public at large. Whether ABC Ltd. can capitalize expenditure incurred on these items as property, plant and equipment (PPE)? If yes, how should these items be depreciated and presented in the financial statements of ABC Ltd.?
	a) With reference to para 7, 9 and 16 of Ind AS 16, even though ABC Ltd. may not be able to recognise expenditure incurred on these assets as an individual item of property, plant and equipment in many cases

	(where it cannot restrict others from using the asset), expenditure incurred may be capitalised as a part of overall cost of the project. From this, it can be concluded that, in the extant case the expenditure incurred on these assets, i.e., railway siding, road and bridge, should be considered as the cost of constructing the refinery and accordingly, expenditure incurred on these items should be allocated and capitalised as part of the items of property, plant and equipment of the refinery. b) Depreciation- if these assets have a useful life which is different from the useful life of the item of property, plant and equipment to which they relate, it should be depreciated separately. However, if these assets have a useful life and the depreciation method that are the same as the useful life and the depreciation method of the item of property, plant and equipment to which they relate, these assets may be grouped in determining the depreciation charge. If it has been included in the cost of property, plant and equipment as a directly attributable cost, it will be depreciated over the useful lives of the said property, plant and equipment. The useful lives of these assets should not exceed that of the asset to which it relates. c) These assets should be presented within the class of asset to which they relate.
9.	Sitting fees paid to independent director and Non-executive director is required to be disclosed in the financial statements prepared as per Ind AS?
	a) In accordance with the definition of key management personnel (KMP) in Ind AS 24, Related Party Disclosures, KMP includes any director of the entity who is having authority and responsibility for planning, directing and controlling the activities of the entity. Accordingly, independent and non-executive directors are also covered under the definition of KMP in accordance with the Ind AS. b) The sitting fees paid to directors will fall under the definition of "Short-term employee benefits" as per Ind AS 19 and is required to be disclosed in accordance with the paragraph 17 of Ind AS 24.

3.2 Compliance of Ind AS by Payment Banks and Small Finance Banks

MCA has clarified that if the holding company is covered by corporate sector roadmap for implementation of Ind AS it shall follow the corporate sector roadmap. If the company has got payment bank or small finance bank as its subsidiary then the subsidiary shall comply with banking sector roadmap prescribed vide RBI circular dated 11th February 2016 read with circular dated 6th October 2016 on 'Operating Guidelines for Payment Banks'. However, the payment banks or small finance bank shall provide the Ind AS financial data to its holding company for the purpose of consolidation.

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