

Query No. 25

Subject: *Classification of consumer deposits collected for LPG connections.*¹

A. Facts of the Case

1. The querist has stated that public sector unit - oil companies, collectively referred to as Oil Marketing Companies (OMCs) are primarily engaged in the business of refining and marketing of petroleum products. Among other products, OMCs sell LPG (Liquid Petroleum Gas) to domestic as well as non-domestic customers. OMCs supply LPG (Liquid Petroleum Gas) in cylinders which are fitted with specially designed valves and regulators.

2. OMCs normally take deposits for cylinders and regulators from consumers. These deposits are taken based on the number of cylinders issued and deposit amount is uniform pan India. As per the agreement, customer can surrender the connection anytime and OMCs are obliged to repay the full deposit amount.

3. The querist has informed that in practice, not even 5% of the consumers surrender the connection and seek refund of the deposit. Due to this, the deposit balance never reduces year to year rather keeps on increasing due to business growth.

4. Guidance under Indian Accounting Standard (Ind AS) 1, 'Presentation of Financial Statements' and Schedule III of the Companies Act, 2013 has been reproduced by the querist as follows:

Ind AS 1, Presentation of Financial Statements:

“Current liabilities

69 An entity shall classify a liability as current when:

- (a) **it expects to settle the liability in its normal operating cycle;**
- (b) **it holds the liability primarily for the purpose of trading;**
- (c) **the liability is due to be settled within twelve months after the reporting period; or**
- (d) **it does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period (see paragraph 73). Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.**

An entity shall classify all other liabilities as non-current.”

General Instructions for Preparation of Balance Sheet Under Division II – Ind AS Schedule III to the Companies Act, 2013:

“3. An entity shall classify a liability as current when-

- (a) it expects to settle the liability in its normal operating cycle;
- (b) it holds the liability primarily for the purpose of trading;

¹ Opinion finalised by the Committee on 8.1.2019.

- (c) the liability is due to be settled within twelve months after the reporting period; or
- (d) it does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.

An entity shall classify all other liabilities as non-current.

5. As per the querist, from a reading of the above paragraphs, two views can be drawn on classification of these deposits:

First View – The OMCs do not have an unconditional right to defer the settlement of these deposits, once presented for repayment, hence the same may be treated as current liability and disclosed accordingly.

Second View – Considering that in commercial practice, these deposits are continued for years together and there is a very minimal re-payment of these deposits, these deposits against LPG connections should be considered as non-current liability, keeping in view the principle of ‘Substance Over Form’.

6. The querist has mentioned that the following criteria under paragraph 10 of Ind AS 8, ‘Accounting Policies, Changes in Accounting Estimates and Errors’ may be considered for determination of the accounting treatment/ classification of these deposits:

“ In the absence of an Ind AS that specifically applies to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is:

- (a) **relevant to the economic decision-making needs of users; and**
- (b) **reliable, in that the financial statements:**
 - (i) **represent faithfully the financial position, financial performance and cash flows of the entity;**
 - (ii) **reflect the economic substance of transactions, other events and conditions, and not merely the legal form;**
 - (iii) **are neutral, ie free from bias;**
 - (iv) **are prudent; and**
 - (v) **are complete in all material respects.”**

While emphasis is hereby drawn on the phrase –‘*economic substance_and not merely their legal form*’, a more comprehensive paragraph on ‘Substance over Form’ has been included in the Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards (hereinafter referred to as the Framework), issued by the Institute of Chartered Accountants of India (ICAI).

(Emphasis supplied by the querist.)

7. The querist has stated that paragraphs 31-38 of the Framework talks about the ‘reliability’ of the information provided in the accounts. To be reliable, Framework lists out the major consideration governing the selection and application of accounting policies which are – Faithful Representation, *Substance over Form*, *Neutrality*, *Prudence & Completeness*.

Paragraph 35 therein elaborates the concept of ‘Substance over Form’ and states, *inter alia*, the following:

“If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form. The substance of transactions or other events is not always consistent with that which is apparent from their legal or contrived form. ...”

(Emphasis supplied by the querist.)

8. Further, LPG deposits are taken against cylinders and regulators issued to LPG consumers at the time of granting connection to them. These cylinders and regulators are forming part of fixed assets of OMCs and are depreciated over the period of their useful lives. Practically, the company is taking these deposits to finance the fixed assets in the form of cylinders and regulators only as per its funds flow planning. Since these deposits are taken against fixed assets of the company, the basic nature of these deposits may suitably be considered as non-current and these deposits should not form part of working capital of the company.

9. The querist has also stated that the Frequently Asked Questions (FAQs) on the Revised Schedule VI to the Companies Act, 1956², issued by the Corporate Laws & Corporate Governance Committee of the ICAI also addresses the same issue of classification of these kinds of deposits as current or non-current as follows:

“Question no. 27 - The company has received security deposit from its customers / dealers. Either the company or the customer / dealer can terminate the agreement by giving two months notice. The deposits are refundable within one month of termination. However, based on past experience, it is noted that deposits refunded in a year are not material, with 1% to 2% of the amount outstanding. The intention of the company is to continue long-term relationship with its customers / dealers. Can the company classify such security deposits as non-current liability?”

Response - As per Revised Schedule VI, a liability is classified as current if the company does not have an unconditional right to defer its settlement for at least 12 months after the reporting date. *This will apply generally. However, in specific cases, based on the commercial practice, say for example electricity deposit collected by the department, though stated on paper to be payable on demand, the company’s records would show otherwise as these are generally not claimed in short term. Treating them as non-current may be appropriate and may have to be considered accordingly.* (Emphasis supplied by the querist.)

A similar criterion will apply to other deposits received, for example, under cancellable leases.”

10. According to the querist, in the above FAQ issued, the principle of substance over form has been preferred over the general condition for classification of liability as current and non-current. Although, the FAQs have been withdrawn by the ICAI but the principle enumerated therein gives guidance in the matter and holds true even today.

11. *Practice followed by OMCs:*

² The said FAQs were subsequently withdrawn in view of issuance of Schedule III of the Companies Act, 2013.

In the above backdrop and emphasizing on the phrase ‘economic reality and not merely their legal form’, the quantum of these deposits for other OMCs during the last few years have been provided by the querist as below:

Rs. Crore				
OMC	Mar'17	Mar'16	Mar'15	Mar'14
Company A	19,790	17,093	14,322	12,633
Company B	10,763	9,183	8,062	6,989

The above table shows the increasing trend of deposits over the past few years for the 2 OMCs mentioned above. If the refunds made on account of these deposits over the last few years are considered, the data looks as follows:

(%ge of Refund Made)	Year Ending Mar'17	Year Ending Mar'16	Year Ending Mar'15	Year Ending Mar'14
Company A	2%	2%	5%	5%
Company B	1%	2%	3%	2%

The above data indicates that *the economic reality with respect to these deposits* suggests that over the past few years, OMCs have been building up its liability towards such deposits taken and the amount of refund has been minuscule as compared to the total liability towards such deposits. Also the gross block of LPG cylinders and regulators is always more than these deposits outstanding. (Emphasis supplied by the querist.)

12. Considering the fact that the company needs to take into account the relevant provisions of Accounting Standard (in this particular case Ind AS 8), these liabilities are classified as non-current by the above mentioned two OMCs taking into account the economic reality and the principle of substance over legal form as explained above. This accounting treatment is also agreed by the auditors of the company of the querist in first Ind-AS financial statements. However, since different views are possible in classification of these deposits, the company has decided to take an opinion of experts in the matter.

13. In addition to the above, given that such deposits are repayable on demand and timing of the payment cannot be estimated, the said deposits have not been discounted in accounts while classifying them as non-current liabilities.

B. Query

14. In view of the above, the querist has sought the opinion of the Expert Advisory Committee on the issue as to whether the accounting classification made by the OMCs for deposits received by them from their LPG consumers towards supply of cylinders and regulators as non-current financial liability is correct.

C. Points considered by the Committee

15. The Committee while giving its opinion has considered only the issue raised in paragraph 14 above and has not examined any other issue that may arise from the Facts of the Case, such as, measurement and consequential discounting, if any, in respect of the said deposits and any other related matters.

16. The Committee notes that the basic issues which need to be considered are whether the deposits received by the company from their LPG customers towards supply of cylinders and regulators are to be treated as non-current liability as per the criteria for current and non-current classification of liabilities under Division II - Ind AS Schedule III of the Companies Act, 2013, Ind AS 1, 'Presentation of Financial Statements' and other applicable Indian Accounting Standards, as notified under the Companies (Indian Accounting Standards) Rules, 2015 as well as whether it meets the definition of a financial liability under Ind AS 32, 'Financial Instruments – Presentation', notified under the Companies (Indian Accounting Standards) Rules, 2015.

17. With regard to the classification of consumer deposits, as non-current liabilities, the Committee notes the following definition of 'Current Liability' as per paragraph 69 of Ind AS 1:

“69 An entity shall classify a liability as current when:

- (a) it expects to settle the liability in its normal operating cycle;**
- (b) it holds the liability primarily for the purpose of trading;**
- (c) the liability is due to be settled within twelve months after the reporting period; or**
- (d) it does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period (see paragraph 73). Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.**

An entity shall classify all other liabilities as non-current.”

From the above, the Committee notes that paragraph 69(d) specifically states that if the entity does not have an unconditional right to defer the settlement of a liability beyond 12 months then the same shall be classified as current liability. The Committee also notes that paragraph 3 of General Instructions for Preparation of Balance Sheet Under Division II - Ind AS Schedule III to the Companies Act 2013 provides similar definition of the current liability. In the extant case, the OMCs are required to refund the deposits as and when the connection is surrendered by the customer and do not have an unconditional right to defer such settlement. Therefore, as per the aforesaid definition, the same should be classified as 'current liability'.

18. With regard to the contention of the querist for considering the principle of 'substance over form' in the extant case, the Committee notes the following requirements from Ind AS 8, Ind AS 1 and the Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards, issued by the ICAI:

Ind AS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors':

“10 In the absence of an Ind AS that specifically applies to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is:

- (a) relevant to the economic decision-making needs of users; and**

- (b) **reliable, in that the financial statements:**
- (i) **represent faithfully the financial position, financial performance and cash flows of the entity;**
 - (ii) **reflect the economic substance of transactions, other events and conditions, and not merely the legal form;**
 - (iii) **are neutral, ie free from bias;**
 - (iv) **are prudent; and**
 - (v) **are complete in all material respects.”**

Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards:

“True and fair view

46 Financial statements are frequently described as showing a true and fair view of the financial position, performance and cash flows of an entity. Although this *Framework* does not deal directly with such concepts, *the application of the principal qualitative characteristics and of appropriate accounting standards normally results in financial statements that convey what is generally understood as a true and fair view of such information.”*

Ind AS 1, Presentation of Financial Statements:

“15 Financial statements shall present a true and fair view of the financial position, financial performance and cash flows of an entity. Presentation of true and fair view requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the *Framework*. The application of Ind ASs, with additional disclosure when necessary, is presumed to result in financial statements that present a true and fair view.”

“17 In virtually all circumstances, presentation of a true and fair view is achieved by compliance with applicable Ind ASs. Presentation of a true and fair view also requires an entity:

- (a) to select and apply accounting policies in accordance with Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*. Ind AS 8 sets out a hierarchy of authoritative guidance that management considers in the absence of an Ind AS that specifically applies to an item.
- (b) to present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information.
- (c) to provide additional disclosures when compliance with the specific requirements in Ind ASs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity’s financial position and financial performance.”

“19 In the extremely rare circumstances in which management concludes that compliance with a requirement in an Ind AS would be so misleading that it

would conflict with the objective of financial statements set out in the Framework, the entity shall depart from that requirement in the manner set out in paragraph 20 if the relevant regulatory framework requires, or otherwise does not prohibit, such a departure.”

(Emphasis supplied by the Committee.)

From the above, the Committee notes that paragraph 10 of Ind AS 8 specifically states that in the absence of an Ind AS that specifically applies to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is reliable, in that the financial statements reflect the economic substance of transactions, other events and conditions, and not merely the legal form. Thus, the Committee is of the view that where a specific transaction or event is covered by a specific requirement of an Ind AS, the general principles, like ‘substance over form’ should not override a specific provision given in the standard. Further, the Committee notes that the Framework and Ind AS 1 also specifically state that the application of accounting standards is presumed to result in financial statements that present a true and fair view and virtually in all circumstances (except in certain extremely rare circumstances as per paragraph 19 of Ind AS 1), presentation of true and fair view is achieved by compliance with applicable Ind ASs. Accordingly, the Committee is of the view that since as per paragraph 69(d) of Ind AS 1, the consumer deposits in the extant case need to be classified as ‘current liabilities’, the same should be followed by the company in the extant case. In this regard, the Committee further notes paragraph 61 of Ind AS 1 which provides as follows:

“61 Whichever method of presentation is adopted, an entity shall disclose the amount expected to be recovered or settled after more than twelve months for each asset and liability line item that combines amounts expected to be recovered or settled:

- (a) no more than twelve months after the reporting period, and**
- (b) more than twelve months after the reporting period.”**

From the above, the Committee is of the view that for better presentation and disclosure, the company should disclose the amount expected to be recovered or settled after more than twelve months for each asset and liability.

19. With reference to the classification of consumer deposits as a financial liability, the Committee notes the following paragraphs of Ind AS 32, ‘Financial Instruments: Presentation’:

“A *financial liability* is any liability that is:

- (a) a contractual obligation :**
 - (i) to deliver cash or another financial asset to another entity; or**
 - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or**
- ...”**

“13 In this Standard, ‘contract’ and ‘contractual’ refer to an agreement between two or more parties that has clear economic consequences that the parties have little, if

any, discretion to avoid, usually because the agreement is enforceable by law. Contracts, and thus financial instruments, may take a variety of forms and need not be in writing.

- 14 In this Standard, ‘entity’ includes individuals, partnerships, incorporated bodies, trusts and government agencies.”

With regard to the classification of the deposits collected as a financial liability, the Committee notes that since as per the agreement, customer can surrender the connection anytime and OMCs are obliged to repay the full deposit amount as stated in paragraph 2 above, there exists a contractual obligation to deliver cash in terms of paragraphs 11 and 13 of Ind AS 32, reproduced above, irrespective of the type of customers in the context of paragraph 14 of Ind AS 32, reproduced above. Accordingly, the same should be classified as ‘financial liability’ by the company in the extant case.

D Opinion:

20. On the basis of the above, the Committee is of the opinion on the issue raised in paragraph 14 above that classification made by the OMCs for deposits received by them from their LPG consumers towards supply of cylinders and regulators as non-current financial liability is not appropriate and the same should be classified as current financial liability as discussed in paragraphs 17, 18 and 19 above, primarily since the OMC does not have the unconditional right to defer settlement of the liability for at least twelve months after the reporting period.
