

Query No. 4

Subject: Presentation and classification of dues recoverable from banks on account of invocation of bank guarantee.¹

A. Facts of the Case

1. A Company (hereinafter referred to as ‘the Corporation’ or ‘the Company’) is a Government of India enterprise (public sector undertaking) under the Ministry of Micro, Small and Medium Enterprises (MSME). The Company has been working to promote, aid and foster the growth of micro, small and medium enterprises in the country. The Company operates through countrywide network of offices and technical centers in the country. In addition, it has set up training cum incubation centre managed by professional manpower.

2. The Company facilitates micro, small and medium enterprises with a set of specially tailored scheme to enhance their competitiveness. The Company provides integrated support services under marketing, technology, finance and other support service. Amongst the various schemes of the Company, financing for procurement of raw material (short term) is one of the flagship schemes and is being carried out by the Company. The scheme is called as ‘Raw Material Assistance Scheme (RMA) against the Security of BG’.

3. The purpose of the scheme is to assist micro, small and medium enterprises (MSME) in procuring their essential raw material(s) (both indigenous and imported) on credit; the Company arranges to provide raw material as per specific needs and requirement of the unit(s). This gives an opportunity to MSMEs to focus better on manufacturing quality products.

4. The salient features of the scheme are as follows:

- a) Financial assistance for procurement of raw materials up to 90 days.
- b) Bulk purchase of basic raw materials at competitive rates.
- c) The Company facilitates import of scarce raw materials.
- d) The Company takes care of all the procedures, documentation and issue of letter of credit in case of imports.
- e) The facilitation under the scheme is for procurement of:
 - Bulk raw materials namely aluminum, zinc, copper, iron & steel, cement etc., which are arranged through the Company entering into a Memorandum of Understanding (MoU) with their manufacturers.
 - Raw materials from the suppliers (other than with whom MOU arrangement is made) on the specific request of the micro, small and medium enterprises.

Under both arrangements, the supplier is selected by the MSMEs and payment at the request of unit is released by the Company directly to the supplier / manufacturer of the raw materials.

5. Accounting treatment for the financial assistance released by the Company for procurement of raw materials to the supplier on behalf of the MSME unit against the security of bank guarantee (BG):

¹ Opinion finalised by the Committee on 21.4.2020.

1. Against the application from MSME for the purpose of sanctioning of limit for raw material assistance against the security of BG and after due compliance of procedure for sanctioning of the limit (comprising of pre-sanction inspection of the unit, credit worthiness report and financial appraisal), limit sanction letter is issued.
2. After sanctioning of limit and before disbursement of assistance, various documents which inter-alia includes agreement, material receipt note, demand promissory note, letter of continuity, BG from approved bank along-with its SFMS confirmation and/or confirmation from the BG issuing bank & its controlling office and personal guarantee of the Directors/ Partners/ Proprietor/ Society Office Bearers, are collected from the MSME unit. All the documents are thereafter vetted legally.
3. After confirming all the documents being in order, the MSME unit submits the invoice of the supplier for disbursement directly to the supplier against the vacant limit available w.r.t. the BGs submitted. It is apt to mention that maximum disbursement can be made is 95% of the BG value or the vacant limit available, whichever is lower.
4. While disbursement of the financial assistance, it is ensured that the total outstanding dues (including the proposed financial assistance), interest, processing fees and miscellaneous expenses, if any, do not exceed the value of the BGs submitted against the overall limit sanctioned, at any point of time.
5. Since the bank guarantee is considered to be unsecured by virtue of an earlier opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India (ICAI) dated 15/09/82 (a copy of the opinion has been supplied separately by the querist for the perusal of the Committee), therefore the dues recoverable from MSMEs against the security of BG are also considered as '*Loans and Advances - Unsecured Considered Good*'. While preparing the annual accounts, such dues are reflected under Note-19 – '*Short Term Loans and Advances*' under the head '*Loans and Advances - Unsecured Considered Good (Backed by BG)*'. The extract of Note-19 of the audited annual accounts for the year 2017-18 has been provided separately by the querist for the perusal of the Committee.
6. In case, the BGs are invoked by the Corporation due to default made by the MSME unit in repayment of dues of raw material assistance and the respective bank has not honored/paid the invoked amount of BG to the Corporation as on 31st March of the financial year, the dues are shown as recoverable from the respective bank instead of the MSME unit, who has submitted the BG issued by the respective bank in favour of the Corporation. Such depiction has been followed by the Corporation since 2017-18 only. While preparing the annual accounts, such dues are reflected under Note-19 – '*Short Term Loans and Advances*' under the head '*Advance Recoverable in Cash or in Kind or for Value to be Received - Unsecured Considered Good – from banks (Backed by BG)*'. The extract of Note-19 of the audited annual accounts for the year 2017-18, has been provided separately by the querist for the perusal of the Committee.
7. It is apt to mention that in accordance with the Notification dated March 30, 2016, issued by the Ministry of Corporate Affairs, the Corporation has adopted Indian Accounting Standards (referred to as 'Ind AS') notified under the

Companies (Indian Accounting Standards) Rules 2015 (as amended) with effect from April 1, 2018. Therefore, the corporation's first Ind AS financial statements is for the period ending 31/03/19 with comparative figures as on 31/03/18 and 01/04/17.

8. In the financial statements under Ind AS for the financial year 2019-20, the dues recoverable from MSMEs against the security of BG are continued to be reflected under Note-14 – “Loans and Advances” under the head “*Covered by Bank/ Government Guarantees*”. The extract of Note-14 for the year 2018-19, has been provided separately by the querist for the perusal of the Committee. However, amount recoverable from banks against the BGs invoked but not yet received, have been reflected under Note-15- “*Other Financial Assets*” under the head “*Receivables from Banks-Others*”, following the guidelines applicable under Ind AS. The extract of Note- 15 for the year 2018-19 has also been provided separately by the querist for the perusal of the Committee.

(Emphasis supplied by the querist.)

6. The querist has informed the basis for depicting amount recoverable from banks against the BGs invoked but not yet received under “*Advance Recoverable in Cash or in Kind or for Value to be Received - Unsecured Considered Good – from banks (Backed by BG)*” under Note-19 during 2017-18 and under Note-15- “*Other Financial Assets*” under the head “*Receivables from Banks-Others*” during 2018-19, respectively, inter-alia includes various covenants of the bank guarantee(s) as mentioned below:

1. *At the outset, it is pertinent to clarify that the bank guarantee is tripartite agreement between banker (bank), the beneficiary (the Corporation) and the MSME unit, in which the bank become the surety for the transaction between the beneficiary (the Corporation) and MSME unit. It is a written contract given by a bank on behalf of a customer (MSME unit), wherein the bank undertakes to pay or discharge the liability of the customer in case of any default. In case the beneficiary invokes the bank guarantee and a letter invoking the same is sent in terms of the bank guarantee, it is obligatory on the bank to make payment to the beneficiary.*
2. *On invocation of the BGs, the primary liability for the payment against such invoked BGs is of the bank. Hence, in the financial statements for the financial year (2017-18), it was felt necessary for showing the dues recoverable from the banks on account of invocation of BGs, separately so that the reader of financial statements of the Corporation should understand the correct picture.*
3. *The querist has given some of the extracts from the Bank Guarantee Bond which are as follows:*
 - We, ..., hereinafter referred to bank at the request of M/s ... (Borrower) do hereby undertake to pay to the Corporation an amount ... against any loss or damage caused to or suffered or would be caused or suffered by the Corporation by reason of any breach by the said Borrower of any of the terms and conditions ... of the unit.
 - The Bank further agree that the Corporation shall be sole judge whether the said Borrower has committed any breach or breaches of any of the terms and conditions of the said agreement and the extent of loss, damage, cost, charges and expenses suffered due to any default / delay on the part of Borrower in

payment of Corporation's dues, other charges, expenses or payment demanded by the Corporation in terms of the said agreement. The bank hereby also waive in favour of the Corporation all rights and defense / plea to which as guarantor the bank may be entitled to. *To give effect to this guarantee, the Corporation may act as though the bank were the principal debtors.*

- *The Bank do hereby undertake to pay the amounts due and payable under this guarantee without any demur, merely on a demand from the Corporation ... Any such demand made on the bank shall be conclusive as regards the amount due and payable by the bank under this guarantee ...*
- The bank undertake to pay to the Corporation any money so demanded notwithstanding any dispute or disputes raised by the Borrower in any suit or proceeding pending before any court or Tribunal relating thereto, bank's liability under these presents being absolute and unequivocal ... ”
- The bank further agrees that the Corporation shall have the fullest liberty ... and the bank shall not be relieved from its liability by reason of any such variation or extension being granted to the said Unit or for any forbearance, act or omission on the part of the Corporation or any indulgence by the Corporation to the said Unit or by any such matter or thing whatsoever which under the laws relating to sureties would, but for this provision have the effect of so relieving the bank.
- The copy of BG issued by Bank, has been provided separately by the querist for the perusal of the Committee.

(Emphasis supplied by the querist.)

7. The detailed *facts of the dispute* have been provided separately by the querist for the perusal of the Committee.

8. During the course of audit of accounts of the Corporation for the year ending 31st March, 2018, Dy. Director of Indian Audit & Accounts Department, Office of the Principal Director of Commercial Audit & Ex-Officio Member, Audit Board-1, New Delhi, had raised observation w.r.t. regrouping of disputed advance amount backed by BG carried out during 2017-18 requires to be modified and outstanding dues be restored to initial classification done in 2016-17. The copy of letter issued by the office of MAB has been supplied separately by the querist for the perusal of the Committee. In this regard, the observation raised and the corresponding reply along with assurance submitted by the management are reiterated as below:

<p><u>Half Margin (HM) No. 8</u> Balance Sheet-Assets- Short Term Loan & Advances (Note 19)- Rs. 295128.12 lakh</p> <p>The Corporation got reconfirmation of its BGs during 2016-17, whereupon it came to notice of the Corporation that BGs amounting to Rs. 17350 lakh against which outstanding RMA dues amounted to Rs. 17057.38 lakh, have been invoked by Union Bank of India (bank). Accordingly,</p>	<p>With reference to said HM, it is pertinent to mention that the bank referred therein should be read as ... bank.</p> <p>Further, it is stated that during the financial year 2016-17, this amount was shown as a footnote against the relevant</p>
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the Corporation accounted for the above outstanding RMA dues of Rs. 17057.38 lakh in above Account Head under Other Loans & Advances. Pay Orders (POs) amounting to Rs. 15350 lakh (Annexure I enclosed) in favour of the Corporation were directly received by MSME units from bank and were deposited on the pretext of settlement of RMA dues; these POs were issued by bank upon invocation of BGs during 2013-14 to 2015-16.

During 2017-18, the Corporation has regrouped outstanding dues of Rs. 17057.38 lakh by deducting from Other Loan & Advances (which includes outstanding RMA dues of MSME units) and adding it to Advance Recoverable in Cash or in Kind or for value to be received (which includes BGs sent by the Corporation for invocation against which amount has not been received from Bank). The above regrouping has resulted in following accounting errors:

1. BG is in the nature of a guarantee and no accounting entry is passed at the time of its receipt. Hence accounting a guarantee as "Advance Recoverable" is not correct.
2. The above regrouping leads to an inference that no due is recoverable from MSME units, whereas the fact is that MSME units have improperly invoked the BGs and adjusted their Outstanding RMA dues of Rs. 15350 lakh by depositing POs directly obtained from bank upon invoking BGs without notice of the Corporation.

In view of above, regrouping done in 2017-18 requires to be modified and outstanding dues be restored to initial classification done in 2016-17. The fact of POs amounting to Rs. 15350 lakh improperly utilized by MSME units to

head in Note-19, which comprises of such amount. The BGs issued by the bank guarantees that the amount shall be paid by it '... under this guarantee without any demur'. As in these cases, the outstanding dues are backed by original valid BGs and invocation claim by the Corporation has been submitted with the bank within the validity period of the BGs, the amount is recoverable from the bank (bank). On invocation of the BGs, now the primary liability for the payment against such invoked BGs is of the bank. Hence, in the current year (2017-18) financial statements, it has been felt necessary for showing it separately so that the reader of financial statements of the Corporation should understand the correct picture.

Accordingly, in order to depict correct, true and fair picture of the state of affairs in the Consolidated Financial Statements of the Corporation for the year 2017-18, the amount recoverable from the bank towards invoked BGs has been shown separately along with re-grouping of the outstanding dues w.r.t. corresponding previous year figures has been carried out.

Though the BG is in the nature of guarantee and no accounting entry is passed in the books of account in respect of BG as such, the amount receivable from any person/unit irrespective of the security backing such receivables are shown under the head "Advance Recoverable in cash or in kind or for value to be received" under Note 19 itself. Hence, accounting of receivables from bank as "Advance Recoverable" is correct.

In view of the above, audit is requested to kindly drop the para.

Since, the Corporation is in possession of original BGs issued by bank and invocation in respect of those BGs has

<p>settle RMA dues needs disclosure.</p>	<p>already been made, the contention/claim of the bank is not tenable and would not immune bank in any way from their obligation for making payment. It is pertinent to mention that on invocation of any bank guarantee the primary responsibility to make the payment of rightful invocation of the BGs is lying with the bank.</p> <p>In view of the above, regrouping done in 2017-18 requires no modification and Outstanding dues need not to be restored to initial classification done in 2016-17.</p> <p>In view of the above, audit is requested to kindly drop the para.</p>
<p>Provisional Comment (PC) 1 : Balance Sheet Assets Short Term Loan & Advances (Note 19)- Rs. 295128.12 lakh</p> <p>The Corporation got reconfirmation of its BGs during 2016-17, where upon it came to notice of the Corporation that BGs amounting to Rs. 17350 lakh against which outstanding RMA dues amounted to Rs. 17057.38 lakh, have been invoked by Bank. Accordingly, the Corporation accounted for the above outstanding RMA dues of Rs. 17057.38 lakh in above Account Head under Other Loans & Advances. Pay Orders (POs) amounting to Rs. 15350 lakh (Annexure I enclosed) in favour of the Corporation were directly received by MSME units from bank and were deposited on the pretext of settlement of RMA dues; these POs were issued by bank upon invocation of BGs during 2013-14 to 2015-16.</p> <p>During 2017-18, the Corporation has regrouped outstanding dues of Rs. 17057.38 lakh by deducting from Other Loan & Advances (which includes outstanding RMA dues of MSME units) and adding it to Advance Recoverable in Cash or in Kind or for value to be received</p>	<p>This is further to our reply dtd. 04.09.2018 to the HM-8.</p> <p>At the outset, it is pertinent to clarify that the bank guarantee is tripartite agreement between banker (bank), the beneficiary (the Corporation) and the MSME unit, in which the bank becomes the surety for the transaction between the beneficiary (the Corporation) and MSME unit. It is a written contract given by a bank on behalf of a customer (MSME unit), wherein the bank undertakes to pay or discharge the liability of the customer in case of any default. In case the beneficiary invokes the bank guarantee and a letter invoking the same is sent in terms of the bank guarantee, it is obligatory on the bank to make payment to the beneficiary.</p> <p>In this regard, we would like to refer the covenants of the bank guarantee(s) issued by the bank, Kolkata, which inter-alia includes the following:</p> <p><i>“We, ... hereinafter referred to ... bank at the request of M/s... (Borrower) do hereby</i></p>

<p>(which includes BGs sent by the Corporation for invocation against which amount has not been received from Bank). The above regrouping has resulted in following accounting errors:</p> <ol style="list-style-type: none"> 1. BG is in the nature of a guarantee and no accounting entry is passed at the time of its receipt. Hence accounting a guarantee as “Advance Recoverable” is not correct. 2. The above regrouping leads to an inference that no due is recoverable from MSME units, whereas the fact is that MSME units have improperly invoked the BGs and adjusted their Outstanding RMA dues of Rs. 15350 lakh by depositing POs directly obtained from bank upon invoking BGs without notice of the Corporation. 3. Classification and sub classification of Short-Term Loan & Advances is not in accordance with Schedule III of Companies Act, 2013 <p>In view of above, regrouping done in 2017-18 requires to be modified and outstanding dues be restored to initial classification done in 2016-17. The fact of POs amounting to Rs. 15350 lakh improperly utilized by MSME units to settle RMA dues needs disclosure.</p>	<p><i>undertake to pay to the Corporation an amountagainst any loss or damage caused to or suffered or would be caused or suffered by the Corporation by reason of any breach by said Borrower of any of the terms and conditions</i></p> <ol style="list-style-type: none"> 1) <i>The Bank further agree that the Corporation shall be sole judge whether the said Borrower has committed any breach or breaches of any of the terms and conditions of the said agreement and the extent of loss, damage, cost, charges and expenses suffered due to any default / delay on the part of Borrower in payment of Corporation’s dues, other charges, expenses or payment demanded by the Corporation in terms of the said agreement. The bank hereby also waive in favour of the Corporation all rights and defense / plea to which as guarantor the bank may be entitled to. To give effect to this guarantee, the Corporation may act as though the bank were the principal debtors.</i> 2) <i>The Bank do hereby undertake to pay the amounts due and payable under this guarantee without any demur, merely on a demand from the Corporation ... Any such demand made on the bank shall be conclusive as regards the amount due and payable by the bank under this guarantee....</i> 3) <i>The bank undertake to pay to the Corporation any money so demanded notwithstanding any dispute or disputes raised by the Borrower in any suit or proceeding pending before any court or Tribunal relating thereto, bank’s liability under these presents being absolute and unequivocal...</i> <p>As in these cases, the outstanding dues are backed by original valid BGs and invocation claim by the Corporation has been submitted with the bank within the validity period of the BGs, the amount is recoverable from the bank (bank). On</p>
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invocation of the BGs, *now the primary liability for the payment against such invoked BGs is of the bank, which is also in line with the conditions agreed by the bank in the Bank Guarantee(s).*

Further in this regard, it is pertinent to mention that the Ministry of MSME after examination of the case and finding of the CID, based on the QDEB report, has regularly taken up the matter with Department of Financial Services (DFS), Ministry of Finance asking the later to impress upon the bank to honour the Corporation's rightful invocation of bank guarantee worth Rs. 173.50 crore together with interest from the date of invocation. Copy of the letters dated 26.02.2018 and 09.05.2018 of Secretary, Ministry of MSME addressed to Secretary, DFS, Ministry of Finance is attached herewith, wherein this fact is reiterated that rightful invocation claims are payable by bank to the Corporation.

We would also like to refer the OM No. 017/IND/009/388778 dated 03/08/18, of Central Vigilance Commission addressed to Cabinet Secretary wherein it is mentioned that the Cases of wrongful invocation of BGs / BGs not issued valuing Rs 173.50 crore, has been examined by the commission. *'The commission has observed several lapses on part of concerned banks in banking procedures while dealing with invocation of BGs in this case'*.

'Hence, commission is of the opinion that a meeting may be convened with the senior officers from Directorate of Financial Services and Ministry of Small and Medium Enterprises by Cabinet Secretary to resolve the issue'.

From the facts stated above, it can be seen that the primary liability for making the payment of invocation claim is of bank. Hence, in the current year (2017-18) financial statements, in order to depict correct, true and fair picture of the state of affairs in the Consolidated Financial

	<p>Statements of the Corporation for the year 2017-18, the amount recoverable from the bank towards invoked BGs has been shown separately under the head “Advance Recoverable in cash or in kind or for value to be received” under Note 19 itself. This has been disclosed in the Note-35 para 5(b). On invocation of the BG while the primary liability for the payment against such invoked BG is of the bank as undertaken by the bank in the guarantee itself (refer para 1 above), the regrouping does not lead to any inference that no dues is recoverable from the unit.</p> <p>In view of the above, regrouping done in 2017-18 requires no modification and Outstanding dues need not to be restored to initial classification done in 2016-17.</p> <p>Further, it is pertinent to mention that the facts related to alleged invocation of bank guarantees by issuance of POs have already been disclosed appropriately in Note 35 para 5(b).</p> <p>As the separate disclosure of the said recoverable amount does not have any impact of the result / profitability as well as state of affairs of the Corporation as on 31.03.2018, audit is requested to drop the PC.</p>
<p>Assurance on the Provisional Comment (PC) -1 on the Audited Accounts for the FY 2017-18</p>	<p>This is further to our letter dated 14.9.2018 on the subject of ‘Clarification w.r.t. Provisional Comment on the Audited Accounts of the Corporation for the year 2017-18’, wherein it was assured that an appropriate disclosure will be made in the notes/ policies for the BGs invoked but amount not realized as on the Balance Sheet date in the ensuing financial year 2018-19.</p> <p>It is also submitted that such depiction will be reviewed in the current financial year 2018-19. Further, in this regard, Corporation will take note of provisions of Ind AS regarding disclosure of such items and in case it is not addressed adequately in the Ind AS, the Corporation shall seek expert opinion from the Institute of Chartered Accountants of India. The depiction / disclosure in the annual</p>

	<p>accounts for the year 2018-19 will be made in compliance with the provisions of Ind AS / ICAI opinion, as applicable.</p> <p>In view of the above, it is requested to drop the provisional comment.</p>
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The copy of replies as referred above has been provided separately by the querist for the perusal of the Committee.

B. Query

9. Considering the facts of the case, the querist seeks the opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India in respect of the following:

Whether the following accounting errors have resulted in due to the reason of re-grouping of outstanding dues of Rs. 17057.38 lakh by shifting from Other Loan & Advances (which includes outstanding RMA dues of MSME units) to Advance Recoverable in cash or in kind or for value to be received (which includes BGs sent by the Corporation for invocation against which amount has not been received from bank) during 2017-18, as mentioned by the Office of Indian Audit & Accounts Department, Office of the Principal Director of Commercial Audit & Ex-Officio Member, Audit Board-1:

1. BG is in the nature of a guarantee and no accounting entry is passed at the time of its receipt. Hence, accounting a guarantee as 'Advance Recoverable' is not correct.
2. The above regrouping leads to an inference that no due is recoverable from MSME units, whereas the facts are that MSME units have improperly invoked the BGs and adjusted their outstanding RMA dues of Rs. 15350 lakh by depositing POs directly obtained from the bank upon invoking BGs without notice of the Corporation.
3. Classification and sub-classification of Short-Term Loan & Advance is not in accordance with Schedule III of Companies Act, 2013.
4. As Ind AS are applicable to the Corporation for the year 2018-19, therefore, in the financial statements under Ind AS for the year 2019-20, the dues recoverable from MSMEs against the security of BG are continued to be reflected under Note-14 – 'Loans and Advances' under the head '***Covered by Bank/ Government Guarantees***'. The draft extract of Note-14 for the year 2018-19, has been provided by the querist for the perusal of the Committee.

However, amount recoverable from banks against the BGs invoked but not yet received, have been reflected under Note-15- '*Other Financial Assets*' under the head '***Receivables from Banks-Others***', following the guidelines applicable under Ind AS.

Whether such depiction requires to be modified and outstanding dues to be restored to initial classification done in 2016-17 i.e amount recoverable from banks against the BGs invoked but not yet received to be shown as dues recoverable from MSMEs against the security of BG and continued to be reflected under Note-14 – 'Loans and Advances' under the head '***Covered by Bank/ Government Guarantees***'.

5. Further, in terms of ICAI opinion dated 15/09/82 (copy has been provided separately by the querist for the perusal of the Committee), bank guarantee is considered to be unsecured, and accordingly, the dues recoverable from MSMEs against the security of BG are also depicted as '*Loans and Advances - Unsecured Considered Good*', in the annual accounts of the respective field offices & Corporation as a whole. Whether ICAI opinion dated 15/09/82 as on date still holds good i.e. considers the bank guarantee as unsecured.

C. Points considered by the Committee

10. The Committee notes that the basic issues raised in the query relate to (i) presentation of amount recoverable/receivable from the bank against the bank guarantees invoked but not yet received for the financial year 2017-18 (i.e., when Accounting Standards (ASs) notified under the Companies (Accounting Standards) Rules, 2006 and not Indian Accounting Standards (Ind ASs), are applicable to the Company) and for the financial year 2018-19, (i.e., when the Ind ASs, notified under Companies (Indian Accounting Standards) Rules, 2015, as amended from time to time are applicable to the Company) and (ii) regrouping of the amount recoverable or outstanding dues from MSME unit by deducting from 'Other Loans and Advances' and adding to 'Advances recoverable in cash or kind or for value to be received'. The Committee has, therefore, considered only these issues and has not examined any other issue arising from the Facts of the Case, such as, measurement and impairment of receivables from MSMEs or receivables against bank on account of bank guarantee under ASs or Ind ASs, accounting for transition from ASs to Ind ASs as per the requirements of Ind AS 101, 'Firsttime Adoption of Indian Accounting Standards' including accounting for prior period items, if any, recognition of interest (if any) on the BGs invoked against bank but not yet paid by the bank, presentation of receivables from MSME, etc. Further, the opinion, expressed hereinafter is purely from accounting perspective and not from legal perspective, such as, legal interpretation of guarantee bond, etc. Further, the Committee hereinafter has not examined the legal validity or genuineness of the bank guarantees and has presumed that the same are in order and valid from legal perspective. The Committee also notes from the Facts of the Case that the Company is a Non-banking Financial Company and therefore, the Ind ASs are applicable to the Company from the financial year 2018-19 (as also stated by the querist in the Facts of the Case) and in respect of which the financial statements shall be presented in accordance with Division III of Schedule III to the Companies Act, 2013, which has been notified by the Ministry of Corporate Affairs vide Notification dated 11th October, 2018.

11. With regard to presentation of amount recoverable from banks against the bank guarantees invoked but not yet received for the financial year 2017-18 under Accounting Standards (ASs), notified under the Companies (Accounting Standards) Rules, 2006, the Committee notes that the first issue to be examined is whether the receivable from the MSME should be continued to be recognised and disclosed or the same should be derecognised and instead a new receivable against the bank in respect of the bank guarantee should be recognised. In this context, the Committee notes that there is no specific requirement in the accounting standards that deal with derecognition of receivables. Therefore, in this context, the Committee notes the following requirements of the Framework for the Preparation and Presentation of Financial Statements (hereinafter referred to as 'the Framework'), issued by the ICAI:

“49. The elements directly related to the measurement of financial position are assets, liabilities and equity. These are defined as follows:

- (a) An *asset* is a resource controlled by the enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise.

...

50. The definitions of an asset and a liability identify their essential features but do not attempt to specify the criteria that need to be met before they are recognised in the balance sheet. Thus, the definitions embrace items that are not recognised as assets or liabilities in the balance sheet because they do not satisfy the criteria for recognition discussed in paragraphs 81 to 97. ...”

“52. The future economic benefit embodied in an asset is the potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the enterprise. The potential may be a productive one that is part of the operating activities of the enterprise. It may also take the form of convertibility into cash or cash equivalents or a capability to reduce cash outflows, such as when an alternative manufacturing process lowers the costs of production.”

“54. The future economic benefits embodied in an asset may flow to the enterprise in a number of ways. For example, an asset may be:

- (a) used singly or in combination with other assets in the production of goods or services to be sold by the enterprise;
- (b) exchanged for other assets;
- (c) used to settle a liability; or
- (d) distributed to the owners of the enterprise.”

“56. Many assets, for example, receivables and property, are associated with legal rights, including the right of ownership. In determining the existence of an asset, the right of ownership is not essential; thus, for example, an item held under a hire purchase is an asset of the hire purchaser since the hire purchaser controls the benefits which are expected to flow from the item. Although the capacity of an enterprise to control benefits is usually the result of legal rights, an item may nonetheless satisfy the definition of an asset even when there is no legal control. For example, know-how obtained from a development activity may meet the definition of an asset when, by keeping that know-how secret, an enterprise controls the benefits that are expected to flow from it.”

12. Drawing an analogy from the above, the Committee is of the view that an asset should be derecognised from the financial statements when it ceases to meet the definition of ‘asset’ as per paragraph 49(a) of the Framework, i.e., when the asset is no longer a ‘resource controlled’ by the enterprise from which future economic benefits are expected to flow to the enterprise. Therefore, the Committee is of the view that in the extant case, the receivable from the MSME unit should be derecognised by the Company when the receivable is not ‘controlled’ by the Company in such a way that it can no longer obtain expected future benefits out of these. In the extant case, since the Company has obtained BG from the bank in respect of the receivables from MSME units, it shall evaluate that whether on invocation of the BG, the Company still controls the receivables so as to obtain benefits out of these. In other words, whether the Company still has the legal rights or the capacity to control benefits expected to flow from the receivables. Accordingly, the Committee is of the view that the Company in the extant case, should evaluate based on its own facts and circumstances and considering the relevant provisions/terms of the Bank

Guarantee Bond and any other Agreement between the Company and the MSME unit or the bank, as to whether in the extant case, on invocation of the BG, the Company still has a control (through legal right or otherwise as explained above) over the receivables from the MSME units. If after such evaluation, it is concluded that the Company does not have such control, the Company should derecognise the 'Receivable from MSME units' from its financial statements. However, at the same time, since the Company acquires a right to obtain the value of receivables from the bank to the extent of bank guarantee, the Company should also recognise an asset in the form of 'Receivable from bank due to invocation of bank guarantee' provided it meets the definition of 'asset' and the recognition criteria of asset, as reproduced above. In such a case, with regard to the presentation of the receivable from the bank, for the financial year 2017-18, the Committee notes the following requirements of Division I of Schedule III to the Companies Act, 2013 (the requirements of Division III to Schedule III are not effective for financial year 2017-18):

“8.8.5 Short-term loans & advances

- (i) Short-term loans and advances shall be classified as:
 - (a) Loans and advances to related parties (giving details thereof);
 - (b) Others (specify nature).
- (ii) The above shall also be sub-classified as:
 - (a) Secured, considered good;
 - (b) Unsecured, considered good;
 - (c) Doubtful.
- (iii) Allowance for bad and doubtful loans and advances shall be disclosed under the relevant heads separately.
- (iv) Loans and advances due by directors or other officers of the company or any of them either severally or jointly with any other person or amounts due by firms or private companies respectively in which any director is a partner or a director or a member shall be separately stated.

...

8.8.6 Other current assets (specify nature)

This is an all-inclusive heading, which incorporates current assets that do not fit into any other asset categories e.g. unbilled Revenue, unamortized premium on forward contracts etc.

In case any amount classified under this category is doubtful, it is advisable that such doubtful amount as well as any provision made there against should be separately disclosed.”

From the above, the Committee notes that, if a current receivable/asset does not fit into any other category, the Company should classify and present such receivables from the bank under 'Other current assets' and in case any amount is doubtful, it is advisable that such doubtful amount as well as any provision made there against should be separately disclosed. However, in this context, the Committee notes that the Company has presented the receivables from banks under 'Advance recoverable in Cash or in Kind or for value to be received' under 'Short-term Loans and Advances'. In this regard, the Committee

wishes to point out that this sub-head is not specifically given under the Schedule III. Moreover, under such head, expenses which have been prepaid or paid in advance from which either something in cash/kind or their value is to be received in future, should be presented. Further, since receivable from bank against BG invoked cannot be treated as loan and advances by the Company to the bank, these receivables should be classified under ‘Other current assets’ along with a disclosure of the amount, if any, considered doubtful, considering the legal position of dispute with regard to recoverability of the bank guarantee.

13. For the financial year 2018-19, when the Ind AS become applicable to the Corporation, in the context of amount recoverable from MSME or from the bank on invocation of bank guarantee, the Committee notes the following paragraphs of Ind AS 32, ‘Financial Instruments: Presentation’:

“A financial asset is any asset that is:

- (a) cash;**
- (b) an equity instrument of another entity;**
- (c) a contractual right:**
 - (i) to receive cash or another financial asset from another entity; or**
 - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or**

...”

From the above, the Committee notes that amounts receivable from MSME as well as receivable from bank on invocation of guarantee are in the nature of financial asset being a contractual right to receive cash or another financial asset from another entity. In this context, as noted from the above, under previous GAAP, the Company has already derecognised the financial asset in the form of recoverable from MSME and has recognised a new financial asset in the form of recoverable from the bank in its financial statements. The Committee notes that under Ind AS 109, the Company would have been required to assess whether the invocation of bank guarantees would result in the derecognition and the recognition of a new financial asset. However, paragraph 13 and Appendix B of Ind AS 101, ‘First-time Adoption of Indian Accounting Standards’ prohibit retrospective application of some aspects of other Ind ASs. The Committee notes that paragraphs B2 and B3 of Ind AS 101 provide as follows:

“B2 Except as permitted by paragraph B3, a first-time adopter shall apply the derecognition requirements in Ind AS 109 prospectively for transactions occurring on or after the date of transition to Ind ASs. For example, if a first-time adopter derecognised non-derivative financial assets or non-derivative financial liabilities in accordance with its previous GAAP as a result of a transaction that occurred before the date of transition to Ind ASs, it shall not recognise those assets and liabilities in accordance with Ind ASs (unless they qualify for recognition as a result of a later transaction or event).

B3 Despite paragraph B2, an entity may apply the derecognition requirements in Ind AS 109 retrospectively from a date of the entity’s choosing, provided that the information needed to apply Ind AS 109 to financial assets and financial liabilities derecognised as a result of past transactions was obtained at the time

of initially accounting for those transactions.”

14. From the above and if the Company in the instant case has not exercised the option under B3, the Committee is of the view that since the Company had already derecognised the recoverable from MSME and recognised the financial asset as recoverable from the bank on invocation of BGs in the financial year 2017-18 under the previous GAAP, on transition, the Company should not reassess whether the derecognition of the receivables from MSME and recognition of the new receivables/recoverable from the bank (on invocation of BGs) would have been appropriate under Ind AS. However, if the company exercises the option under B3, the Company should reassess that whether the derecognition of financial asset, viz., receivables from the MSME is appropriate or not considering the following requirements of Ind AS 109, ‘Financial Instruments’:

“3.2.3 An entity shall derecognise a financial asset when, and only when:

- (a) the contractual rights to the cash flows from the financial asset expire, or**
- (b) it transfers the financial asset as set out in paragraphs 3.2.4 and 3.2.5 and the transfer qualifies for derecognition in accordance with paragraph 3.2.6.**

(See paragraph 3.1.2 for regular way sales of financial assets.)

3.2.4 An entity transfers a financial asset if, and only if, it either:

- (a) transfers the contractual rights to receive the cash flows of the financial asset, or**
- (b) retains the contractual rights to receive the cash flows of the financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients in an arrangement that meets the conditions in paragraph 3.2.5.”**

“3.2.6 When an entity transfers a financial asset (see paragraph 3.2.4), it shall evaluate the extent to which it retains the risks and rewards of ownership of the financial asset. In this case:

- (a) if the entity transfers substantially all the risks and rewards of ownership of the financial asset, the entity shall derecognise the financial asset and recognise separately as assets or liabilities any rights and obligations created or retained in the transfer.**

...

- (c) if the entity neither transfers nor retains substantially all the risks and rewards of ownership of the financial asset, the entity shall determine whether it has retained control of the financial asset. In this case:**

(i) ... ”

“3.2.7 The transfer of risks and rewards (see paragraph 3.2.6) is evaluated by comparing the entity’s exposure, before and after the transfer, with the variability in the amounts and timing of the net cash flows of the transferred asset. An entity has retained substantially all the risks and rewards of ownership of a financial asset if its exposure to the variability in the present

value of the future net cash flows from the financial asset does not change significantly as a result of the transfer (eg. because the entity has sold a financial asset subject to an agreement to buy it back at a fixed price or the sale price plus a lender's return). An entity has transferred substantially all the risks and rewards of ownership of a financial asset if its exposure to such variability is no longer significant in relation to the total variability in the present value of the future net cash flows associated with the financial asset (eg because the entity has sold a financial asset subject only to an option to buy it back at its *fair value* at the time of repurchase or has transferred a fully proportionate share of the cash flows from a larger financial asset in an arrangement, such as a loan sub-participation, that meets the conditions in paragraph 3.2.5).”

“3.2.9 Whether the entity has retained control (see paragraph 3.2.6(c)) of the transferred asset depends on the transferee's ability to sell the asset. If the transferee has the practical ability to sell the asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without needing to impose additional restrictions on the transfer, the entity has not retained control. In all other cases, the entity has retained control.”

From the above, the Committee notes that an entity shall derecognise a financial asset when it transfers the financial asset, viz., transfers the contractual rights to receive the cash flows of the financial asset and transfers substantially all the risks and rewards of ownership of the financial asset. Paragraph 3.2.6(a) further states that the entity shall recognise separately as assets or liabilities any rights and obligations created or retained in the transfer. In the extant case, since the Corporation has obtained BG from the bank in respect of the receivables from MSME units, it should evaluate that whether on invocation of the BG, the contractual rights to the cash flows from the MSME are transferred to the bank and whether the Corporation has transferred substantially all the risks and rewards of ownership of the financial asset i.e. receivable from MSME, based on its own facts and circumstances and considering the relevant provisions/terms of the Bank Guarantee Bond and any other Agreement between the Company and the MSME unit or the bank. If after such evaluation, it is concluded that the financial asset, viz., receivable from MSME should be derecognised, the Company should derecognise the ‘receivable from MSME units’ from its financial statements. Further, at the same time, considering the requirements of Ind AS 109, the Company should recognise a new financial asset in the form of receivable/recoverable from the bank.

15. With regard to the presentation of the receivable from the bank, for the financial year 2018-19 and onwards, the Committee notes that Division III to Schedule III to the Companies Act, 2013 requires the head ‘Financial Asset’ on the ‘Assets’ side of the balance sheet to be sub-classified as under :

Balance Sheet as on...

	Particulars
	ASSETS
(1)	Financial assets
(a)	Cash and cash equivalents
(b)	Bank Balance other than (a) above
(c)	Derivative financial instruments

(d)	Receivables
	(I) Trade Receivables
	(II) Other Receivables
(e)	Loans
(f)	Investments
(g)	Other Financial assets (to be specified)

Further, the Committee notes paragraph 8.1.7 of the Guidance Note on Division III to Schedule III to the Companies Act, 2013 for NBFC that is required to comply with Ind AS, issued by the ICAI states as follows:

“8.1.7. Other Financial assets:

Other financial assets should include items such as dues in respect of insurance claims, sale of Property, Plant and Equipment, contractually reimbursable expenses, security deposits etc. In case advances are of the nature of a financial asset as per Ind AS 32, these are to be disclosed under ‘other financial assets’ separately.

Other financial assets may also include receivables emanating from items that are classified as ‘other Income’.”

From the above, the Committee notes that the receivables from the bank should be presented under the head ‘Other financial assets’ with an appropriate nomenclature and disclosure so as to reflect and explain nature thereof appropriately.

D. Opinion

16. With reference to the queries raised in paragraph 9 above, the Committee is of the following opinion:

- 1 and 2. At the time of receipt of BG, no accounting entry is required. However, on invocation of BG, the Company should evaluate based on its own facts and circumstances and considering the relevant provisions/terms of the Bank Guarantee Bond and any other Agreement between the Company and the MSME unit or the bank, as to whether on invocation of the BG, it still has a control (through legal right or otherwise as explained above) over the receivables from the MSME units. If after such evaluation, it is concluded that the Company does not have such control, the Company should derecognise the ‘Receivable from MSME units’ from its financial statements, as discussed in paragraph 12 above. Further, an asset in the form of ‘Receivable from bank due to invocation of bank guarantee’ should be created, provided it meets the definition of ‘asset’ as discussed in paragraph 12 above for the financial year 2017-18, i.e., when Accounting Standards (ASs) notified under the Companies (Accounting Standards) Rules, 2006 were applicable to the Company. With respect to the financial year 2018-19 (when Indian Accounting Standards are applicable), the Company should evaluate considering the requirements of Ind AS 109 that, whether on invocation of the BG, the contractual rights to the cash flows from the MSME are transferred to the bank and whether the Corporation has transferred substantially all the risks and rewards of ownership of the financial asset i.e. receivable from MSME, based on the facts and circumstances and considering the relevant provisions/terms of the Bank Guarantee Bond and any other Agreement between the Company and the MSME unit or the bank. If after such evaluation, it is concluded that the

financial asset, viz., receivable from MSME should be derecognised, then the Company should derecognise the 'receivable from MSME units' from its financial statements. Further, at the same time, the Company should recognise a new financial asset in the form of Receivable/recoverable from the bank, considering the requirements of Ind AS 109, as discussed in paragraph 14 above.

- 3 and 5. The receivables from bank on invocation of BGs for the F.Y. 2017-18, should be classified under 'Other current assets' along with a disclosure of the amount, if any, considered doubtful, considering the legal position of dispute with regard to recoverability of the bank guarantee, as discussed in paragraph 12 above. With regard to the issue raised by the querist in context of earlier opinion issued by the Committee in respect of bank guarantee, the Committee is of the view that after Division III to Schedule III to the Companies Act, 2013 becoming applicable to the Company, this question is no longer relevant as it contains specific disclosure requirements in respect of bank guarantees.
4. Subject to paragraphs 13 and 14 above, for the financial year 2018-19 and onwards, the receivables from the bank should be presented under the head "Other financial assets" with an appropriate nomenclature and disclosure so as to reflect and explain the nature thereof appropriately, as discussed in paragraph 15 above.