

## ***Query No. 1***

***Subject: Presentation of advance given to A Ltd. under Current Assets - other current assets.<sup>1</sup>***

### **A. Facts of the Case**

1. A Company (hereinafter referred to as ‘the Company’), is a Schedule ‘A’ and a Mini Ratna (Category-I) Company. It has an authorised capital of Rs. 1000 crore and a paid up capital of Rs. 490.58 crore, out of which the Government of India’s share is 74.71 % and 25.29 % is held by financial institutions and others. The Company currently has a total annual installed capacity of 35.68 LMT (re-assessed capacity of 32.31 LMT) and is the second largest producer of urea in the country with a share of about 16% of total urea production in the country. The Company is engaged in manufacturing and marketing of neem coated urea, three strains of bio-fertilizers (solid and liquid) and other allied industrial products like ammonia, nitric acid, ammonium nitrate, sodium nitrite and sodium nitrate.

2. Urea (fertilizer) is a controlled product and its price is controlled by the Government under its subsidy scheme. The maximum retail price (MRP) of urea is fixed by the Government and is the same for all companies. The Company is also importing and trading various agro-inputs like non-urea fertilizers, certified seeds, agrochemicals, bentonite sulphur, city compost through its existing PAN India dealer’s network under single window concept.

3. The Company had entered into a contract with a foreign supplier, A Ltd. on behalf of the Government of India for supply of 2.00 lakhs metric tonne (LMT) of urea and made advance payment of Rs. 131 crore including advance payment for arranging insurance cover for the supplies. The only shipment of material supplied had been found to be below specification and was not accepted. No supplies for the remaining contracted quantity were received and subsequently the contract was terminated. The matter regarding remittance of the advance payment to A Ltd. and non-supply of material is under litigation.

4. The Company has filed a statement of claim with International Chamber of Commerce, Arbitration Tribunal, Paris. Pending litigation, the net advance of Rs. 129.64 crore (after recovery of Rs. 1.05 crore) has been fully provided for in the earlier years from the revenue reserve and surplus. Pending litigation, net advance of Rs. 129.64 crore and corresponding provision for doubtful advance has been presented under the head ‘Current Asset – Other Current Assets’ in the Balance Sheet.

### ***Government Audit observation on the annual accounts for the financial year (F.Y.) 2020-21***

5. During the course of audit of annual accounts of the Company for the F.Y. 2020-21, Government Audit issued the following audit note on inclusion of advances which are more than 25 years old in ‘Other Current Assets’, in non-compliance of paragraph 66 of Indian Accounting Standard (Ind AS) 1, ‘Presentation of Financial Statements’ resulting in overstatement of other current assets and understatement of other non-current assets by Rs. 129.64 crore:

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<sup>1</sup> Opinion finalised by the Committee on 14.3.2022.

“Audit Note. 3

Ind AS 1 provides that an entity should present current and non-current assets and current liabilities as separate classifications in its Balance Sheet.

Paragraph 66 of Ind AS 1 states that:

**“66 An entity shall classify an asset as current when:**

- (a) it expects to realise the asset, or intends to sell or consume it, in its normal operating cycle;**
- (b) it holds the asset primarily for the purpose of trading;**
- (c) it expects to realise the asset within twelve months after the reporting period; or**
- (d) the asset is cash or a cash equivalent (as defined in Ind AS 7) unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.**

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

A reference is invited to advances (unsecured, considered good unless otherwise stated) Other Current Assets – Note 18 which includes an advance of Rs. 130.69 crore given to a foreign supplier A Ltd. during the year 1995-96 against import of urea, the supplies of which were not received and contract was terminated. Pending litigation, the net advance of Rs. 129.64 crore (after recovery of Rs. 1.05 crore) has been fully provided for in the earlier years.

Inclusion of advances which are more than twenty five years old in other current assets is non-compliance of paragraph 66 of Ind AS 1 stated above and has resulted in overstatement of other current assets and understatement of other non-current assets by Rs. 129.64 crore.”

*Management Reply to Audit Note:*

6. The Company submitted the following reply to the Government Audit in respect of aforesaid Audit Note:

Paragraph 66 of Ind AS 1 states as under:

**“66 An entity shall classify an asset as current when:**

- (a) it expects to realise the asset, or intends to sell or consume it, in its normal operating cycle;**
- (b) it holds the asset primarily for the purpose of trading;**
- (c) it expects to realise the asset within twelve months after the reporting period; or**
- (d) the asset is cash or a cash equivalent (as defined in Ind AS 7) unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.**

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

Paragraph 69 of Ind AS 1 states as under:

**“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.”**

It may be noted that A Ltd. does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date.

Hence, it cannot be said that there is non-compliance of paragraph 66 of Ind AS 1.

It may be noted that in Note 18, the advance to A Ltd. of Rs. 129.64 crore has been fully provided as doubtful advances; *hence the amount paid as advance to A Ltd. appearing in the Note - Other Current Assets is Nil.* (Emphasis supplied by the querist.)

*Government Audit Supplementary Observation through Provisional Comment (PC) No.5 (b):*

7. Government auditors have further pursued their observation of Audit Note after considering reply submitted by Company and have issued Provisional Comment (PC) on the above issue as given below:

“The above includes an amount of Rs. 129.64 crore being provision made for advance of Rs. 130.69 crore given to foreign supplier during the year 1995-96 against import of Urea, the supplies of which were not received and subsequently the contract was terminated. Pending litigation, the net advance of Rs. 129.64 crore (after recovery of Rs. 1.05 crore) has been fully provided for in the earlier years from the revenue reserve and surplus.

The payment of advance of USD 3,76,20,000 was made in 1995-96 (prevailing rate being One USD = Rs. 34.74) equivalent to Rs. 130.69 crore. Against this, a recovery of US \$ 2,25,940 and US \$ 7,935.42 was made in 2003-04 and 2006-07, respectively, at the then prevailing rates. The balance amount of US \$ 3,73,86,124.58 has been provided at the exchange rate prevailing 25 years back i.e., when the advance was given in 1995-96. This is in non-compliance of paragraph 23 of Ind AS 21 which states that foreign currency monetary items shall be translated using the closing rate. Accordingly, the company should have applied exchange rate prevailing as on 31<sup>st</sup> March 2021 which was Rs. 73.5047 per US dollar.

Thus, provision of US \$ 37386124.58 at a 25 years old exchange rate has created a short provision of Rs. 145.17 crore which has resulted in understatement of current assets and understatement of provision by Rs. 145.17 crore.

Further, inclusion of advances which are more than 25 five years old in Other Current Assets is in non-compliance of paragraph 66 of Ind AS 1 resulting in overstatement of other current assets and understatement of other Non-current Assets by Rs. 129.64 crore.”

*Management Reply to Provisional Comment:*

8. The Company submitted the following reply to the Government Audit in respect of aforesaid PC:

Net Advance of Rs. 129.64 crore was given as advance during F.Y. 1995-96 to a foreign supplier A Ltd. for import of Urea, the supplies of which were not received and the contract was terminated. The part of materials supplied has been found below specification has not been accepted. The matter is under litigation.

It is stated that pending litigation, the net advance of Rs. 129.64 crore given to foreign supplier against import of urea, the supplies of which were not received and subsequently the contract was terminated, has been fully provided in the books of account as doubtful advance.

Paragraph 36 of Ind AS 37, ‘Provisions, Contingent Liabilities and Contingent Assets’ states as under:

**“The amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.”**

It is stated that the expenditure the company has incurred due to non-receipt of urea/advance has been fully provided in the books of account during F.Y. 1995-96.

Paragraph 23 of Ind AS 21, ‘The Effects of Changes in Foreign Exchange Rates’ states as under:

**“At the end of each reporting period:**

- (a) foreign currency monetary items shall be translated using the closing rate;**
- (b) non-monetary items that are measured in terms of historical cost in a foreign currency shall be translated using the exchange rate at the date of the transaction; and**
- (c) non-monetary items that are measured at fair value in a foreign currency shall be translated using the exchange rates at the date when the fair value was measured.”**

Paragraph 16 of Ind AS 21 states as under:

“The essential feature of a monetary item is a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency. Examples include: pensions and other employee benefits to be paid in cash; provisions that are to be settled in cash; lease liabilities; and cash dividends that are recognised as a liability.

Similarly, a contract to receive (or deliver) a variable number of the entity's own equity instruments or a variable amount of assets in which the fair value to be received (or delivered) equals a fixed or determinable number of units of currency is a monetary item. Conversely, the essential feature of a non-monetary item is the absence of a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency. Examples include: amounts prepaid for goods and services; goodwill; intangible assets; inventories; property, plant and equipment; right-of-use assets and provisions that are to be settled by the delivery of a non-monetary asset."

It may be seen that the said transaction falls under paragraph 23 (b) above and is in the nature of non-monetary item.

Paragraphs 2 and 8 of Appendix B – Foreign Currency Transactions and Advance Consideration of Ind AS 21, 'The Effects of Changes in Foreign Exchange Rates', inter alia, states as under:

"2 When an entity pays or receives consideration in advance in a foreign currency, it generally recognises a non-monetary asset or non-monetary liability before the recognition of the related asset, expense or income. The related asset, expense or income (or part of it) is the amount recognised applying relevant Standards, which results in the derecognition of the non-monetary asset or non-monetary liability arising from the advance consideration."

"8 Applying paragraphs 21–22 of Ind AS 21, the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part of it) is the date on which an entity initially recognises the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration."

The recoverable amount (being the amount prepaid for supply of goods) is in the nature of non-monetary item and has been translated using the exchange rate at the date of transaction. Hence, there is no non-compliance of Ind AS 21.

Paragraph 66 of Ind AS 1 states as under:

**"66 An entity shall classify an asset as current when:**

- (a) it expects to realise the asset, or intends to sell or consume it, in its normal operating cycle;**
- (b) it holds the asset primarily for the purpose of trading;**
- (c) it expects to realise the asset within twelve months after the reporting period; or**
- (d) the asset is cash or a cash equivalent (as defined in Ind AS 7) unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.**

**An entity shall classify all other assets as non-current."**

Paragraph 69 of Ind AS 1 states as under:

**“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.”**

It may be noted that A Ltd. does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date.

9. In view of above, it is clear that classification of assets as current and non-current depends upon the contractual realisation of the assets and not on the basis of past trend of realisation of assets. Hence, there is no non-compliance of paragraph 66 of Ind AS 1.

10. During the course of discussion regarding above PC with Government Audit, the observation was not pursued based on the assurance given by the Company stating that depiction of above advance given to A Ltd. under current or non-current assets will be reviewed in F.Y. 2021-22.

## **B. Query**

11. On the basis of the above, the querist has sought the opinion of the Expert Advisory Committee on the following issues:

- (i) Whether the presentation of advance given to A Ltd. amounting to Rs. 129.64 crore (fully provided in books of account) in ‘Current Assets – Other Current Assets’ by the Company is correct.
- (ii) In the event the presentation at (i) above is not found correct, then whether fair valuation of the same is required as per Ind AS 113, ‘Fair Value Measurement’.

## **C. Points considered by the Committee**

12. The Committee notes that the basic issues raised in the query relate to presentation of advances given to A Ltd. under the head ‘Other Current Assets’ and whether fair valuation of the same is required as per Ind AS 113. The Committee has, therefore, considered only these issues and has not examined any other issue(s) that may arise from the Facts of the Case, such as, classification of advance as monetary or non-monetary item and exchange rate used for translation in the financial statements as per Ind AS 21, ‘The Effects of Changes in Foreign Exchange Rates’, propriety of accounting for provision for non-recoverability in respect of advance in accordance with Ind AS 37, ‘Provisions, Contingent Liabilities and Contingent Assets’, accounting for advance payment made for arranging insurance, accounting for the recovery made from A Ltd., applicability of requirements of Ind AS 101, ‘First-time Adoption of Indian Accounting Standards and Ind AS 8, ‘Accounting Policies, Changes in Accounting

Estimates and Errors', considerations of materiality, whether the Company is acting in the capacity of principal or as agent of Government, accounting treatment of interest or penalty, if any, receivable due to termination of the Contract, etc. The Committee also wishes to point out that the opinion expressed hereinafter is purely from accounting perspective and not from legal perspective, such as, interpretation of various legal decisions, compliance with RBI guidelines for foreign remittance, etc. Further, the Accounting Standards referred hereinafter are Indian Accounting Standards, notified under the Companies (Indian Accounting Standards) Rules, 2015, as amended/revised from time to time.

13. The Committee notes paragraph 66 of Ind AS 1, 'Presentation of Financial Statements' and Division II of Schedule III to the Companies Act, 2013 provides the definition of 'current asset', as follows:

**“An entity shall classify an asset as current when:**

- (a) it expects to realise the asset, or intends to sell or consume it, in its normal operating cycle;**
- (b) it holds the asset primarily for the purpose of trading;**
- (c) it expects to realise the asset within twelve months after the reporting period; or**
- (d) the asset is cash or a cash equivalent (as defined in Ind AS 7) unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.**

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

From the above, the Committee notes that clause (c) specifically states that an entity shall classify an asset as current when it *expects to realise the asset within twelve months after the reporting period*. Thus, the classification of advance given to A Ltd. as current and non-current depends on the fact that whether the same is expected to be realised within twelve months after the reporting period. The Committee is of the view that while assessing whether the advance is expected to be realised or realisable within twelve months, various factors, such as, expectation of the outcome of litigation (depending on the stage at which litigation is pending and past outcomes), opinions/views of legal experts, the experience of the enterprise in similar cases or earlier judgements issued in similar cases for other entities etc. should be taken into consideration.

Further, the Committee is of the view that since recovery against the advance has not been made by the Company even after 25 years and the fact that the Company has provided for the provision against its doubtful recovery in full, which has not been reversed at the current reporting date strongly indicates that the amount of advance is not realisable in entirety within the next twelve months after the reporting period. Accordingly, the Company should classify the advance as current asset only to the extent it is expected to be realised within the next twelve months after the reporting period taking into consideration various factors as stated above and the balance amount should be classified as non-current asset.

The Committee does not agree with the querist's contention that since from the supplier's (A's) perspective, the advances received is current liability as A Ltd. does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date, same should be treated as current asset in the Company's financial statements.

The Committee is of the view that from the perspective of classification into current and non-current, since the advance is an asset for the Company, it should consider the definition of current asset for the same.

14. In the context of classification and measurement of advances given to A Ltd., 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**

...”

15. The Committee notes that the Company had entered into contract with the foreign supplier, A Ltd. for supply of urea and made advance payment of Rs. 131 crore in the F.Y. 1995-96. The only shipment of material supplied by A Ltd. had been found to be below specification and was not accepted. No supplies for the remaining contracted quantity were received *and subsequently the contract was terminated*. The matter regarding remittance of the advance payment to A Ltd. and non-supply of material is under litigation, as the Company has filed a statement of claim with International Chamber of Commerce, Arbitration Tribunal, Paris. From this, the Committee notes that depending on the terms of contract and the outcome of legal proceedings, the recovery (if any) to be made by the Company may either be in terms of goods or services or in terms of cash.

The Committee is of the view that in case, the Company has the right to receive payment in cash as per the terms of contract, the amounts receivable from A Ltd. is in the nature of a financial asset being a contractual right to receive cash. Accordingly, the Committee is of the view that in the extant case, when such contractual right to receive cash comes into existence for the Company, the Company should recognise it as a financial asset and classify and measure the same as per the requirements of Ind AS 109, 'Financial Instruments'. In this regard, the Committee notes that as per the requirements of paragraph 5.1.1, at initial recognition, an entity shall measure a financial asset at its fair value adjusted by transaction costs in case of a financial asset not at fair value through profit or loss. Further, the fair value should be determined, as per the requirements of Ind AS 113, 'Fair Value Measurement'.

16. In this regard, the Committee also notes that Section 5.5 of Ind AS 109, 'Financial Instruments' deals with impairment recognition based on Expected Credit Loss (ECL) to be created for certain categories of financial instruments including financial assets measured at amortised cost and at fair value through other comprehensive income. Accordingly, the Committee is of the view that the Company should also consider the ECL requirements in respect of the financial asset for right of recovery against advance made to A Ltd., as per the following requirements of Ind AS 109:

- “5.5.1 An entity shall recognise a loss allowance for *expected credit losses* on a financial asset that is measured in accordance with paragraphs 4.1.2 or 4.1.2A, a lease receivable, a *contract asset* or a loan commitment and a financial guarantee contract to which the impairment requirements apply in accordance with paragraphs 2.1(g), 4.2.1(c) or 4.2.1(d).”**
- “5.5.3 Subject to paragraphs 5.5.13–5.5.16, at each reporting date, an entity shall measure the loss allowance for a financial instrument at an amount equal to the *lifetime expected credit losses* if the credit risk on that financial instrument has increased significantly since initial recognition.”**
- “5.5.5 Subject to paragraphs 5.5.13–5.5.16, if, at the reporting date, the credit risk on a financial instrument has not increased significantly since initial recognition, an entity shall measure the loss allowance for that financial instrument at an amount equal to *12-month expected credit losses*.”**
- “5.5.11 If reasonable and supportable forward-looking information is available without undue cost or effort, an entity cannot rely solely on *past due* information when determining whether credit risk has increased significantly since initial recognition. However, when information that is more forward-looking than past due status (either on an individual or a collective basis) is not available without undue cost or effort, an entity may use past due information to determine whether there have been significant increases in credit risk since initial recognition. Regardless of the way in which an entity assesses significant increases in credit risk, there is a rebuttable presumption that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due. An entity can rebut this presumption if the entity has reasonable and supportable information that is available without undue cost or effort, that demonstrates that the credit risk has not increased significantly since initial recognition even though the contractual payments are more than 30 days past due. When an entity determines that there have been significant increases in credit risk before contractual payments are more than 30 days past due, the rebuttable presumption does not apply.”
- “5.5.13 Despite paragraphs 5.5.3 and 5.5.5, at the reporting date, an entity shall only recognise the cumulative changes in lifetime expected credit losses since initial recognition as a loss allowance for purchased or originated credit-impaired financial assets.”**
- “5.5.17 An entity shall measure expected credit losses of a financial instrument in a way that reflects:**
- (a) an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;**
  - (b) the time value of money; and**
  - (c) reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.”**

Accordingly, the Committee is of the view that in the extant case, the Company should follow the above-mentioned requirements of Ind AS 109 in respect of the advance to A Ltd. and then classify the same as current and non-current on the basis of expectations of realisability within twelve months from the reporting period, as discussed in paragraph 13 above. Further, the presentation and disclosure requirements of Division II of Schedule III to the Companies Act, 2013 should also be followed.

17. Further, the Committee is of the view that in case, the Company does not have a contractual right to receive cash; rather has the right to receive appropriate goods or services, the Company should recognise and classify the same as current and non-current asset on the basis of expectations of realisability within twelve months from the reporting period, as discussed in paragraph 13 above. Further, the presentation and disclosure requirements of Division II of Schedule III to the Companies Act, 2013 should also be followed.

#### **D. Opinion**

18. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 11 above:

- (i) The presentation of Advance given to A Ltd. as current asset or non-current asset depends on expectations of realisability within twelve months from the reporting period. The Company should classify the advance as current asset only to the extent it is expected to be realised within the next twelve months after the reporting period taking into consideration various factors, such as, expectation of the outcome of litigation (depending on the stage at which litigation is pending and past outcomes), opinions/views of legal experts, the experience of the enterprise in similar cases or earlier judgements issued in similar cases for other entities etc. and the balance amount should be classified as non-current asset, as discussed in paragraph 13 above. Further, the presentation and disclosure requirements of Division II of Schedule III to the Companies Act, 2013 should also be followed.
- (ii) In case the Company has the right to receive cash as per the terms of contract, the Company should recognise it as a financial asset and classify and measure the same at fair value depending on classification and other applicable requirements of Ind AS 109, 'Financial Instruments, as discussed in paragraphs 14 to 16 above.