

Query No. 28

Subject: Presentation of cash and cash equivalents kept on behalf of clients under Ind AS Framework.¹

A. Facts of the Case

1. A Company (hereinafter referred to as ‘the Company’) is a central public sector enterprise (CPSE) registered under the Companies Act, 1956 (now Companies Act, 2013), and is engaged in the business of engineering consultancy. The Company is a multi-disciplinary engineering and consultancy organisation providing diversified and comprehensive array of services, such as, project management consultancy (PMC), quality assurance, pre-feasibility report (PFR)/detailed project report (DPR), design and drawing, transaction advisory etc. in all facets of transport infrastructure i.e., railways, metros, highways, airports, ports, ropeways, urban transport and inland waterways in India and abroad. The Company is also engaged in construction of project on turnkey basis, export of rolling stock and wet leasing of locomotive to clients engaged in power/mining/metal sector. The Company has four reportable business segments, viz., consultancy, turnkey project, export of rolling stock and leasing of locomotives.

2. Under consultancy segments, the Company executes number of projects on ‘Deposit Work’ basis on behalf of clients. Under this type of work, the Company engages contractor on behalf of client and for making payment to contractor, client deposits upfront money with the Company, which is kept in designated bank accounts and funds in these banks are not freely available for normal business activities of the Company. Depending upon the requirement of funds, funds so deposited by clients are kept in current / flexi / fixed deposit (FD) account(s) and any interest earned on such funds is credited to client account only. Funds so received are represented as liabilities of the Company towards client till use of fund. The bank account is opened and operated by the Company. Since these funds are provided by clients and represented by corresponding liabilities in the books of account of the Company, a suffix ‘client fund’ is attached while representing cash and bank balances in the financial statements. As such, financial statements of the Company present ‘cash and cash equivalents’ and ‘bank balances’ under the following categories:

Non-current Assets - Financial

- a. Bank balances more than 12 months maturity-owned fund
- b. Bank balances more than 12 months maturity-client fund

Current Assets - Financial

- a. Cash and cash equivalent – owned fund
- b. Cash and cash equivalent – client fund
- c. Other bank balances – owned fund
- d. Other bank balances – client fund

3. Since cash and cash equivalent and other bank balances held on behalf of client are not freely available to be used for own purpose by the Company, inflows and outflows in/from

¹ Opinion finalised by the Committee on 10.2.2023.

these client funds are not considered as part of statement of cash flows. The following additional disclosure is being made at the end of the statement of cash flows:

“The above statement of cash flows has been prepared on the basis of the Company’s owned funds only. Funds on behalf of the client and its corresponding liabilities have not been considered.”

4. Significant accounting policies of the Company on “cash and cash equivalents (1.15) and statement of cash flows (1.16)” are reproduced below:

“1.15 Cash and Cash Equivalents

Cash comprises cash on hand and demand deposits with banks. Cash equivalents are short term deposits with an original maturity of three months or less from the date of acquisitions which are readily convertible into known amounts of cash and be subject to an insignificant risk of change in value. Cash and cash equivalents consist of balances with banks which are unrestricted for withdrawal and usage.

1.16 Statement of Cash Flows

Statement of cash flows is made using the indirect method, whereby profit before tax is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future cash receipts or payments and item of income or expenses associated with investing or financing cash flows. The cash flows from operating, financing and investing activities of the Company are segregated.”

5. During supplementary audit of financial statements of the Company for financial year (F.Y.) 2021-22, under section 143(6) of the Companies Act, 2013, office of Comptroller and Auditor General (C&AG) of India through Principal Director of Railway Commercial raised two observations. First one is on disclosure of cash and cash equivalents – client funds and 2nd one is on significant accounting policy of the Company on cash and cash equivalent. Both the observations along with managements’ replies thereon are reproduced below:

Observation 1

“Cash and Cash Equivalent- Client Fund (Note No.1.08) – Rs.137,71,08,949

According to paragraph No. 8.1.16 of Guidance Note on Division II - Ind AS Schedule III to the Companies Act 2013, bank balances other than cash and cash equivalents as above, shall be disclosed below cash and cash equivalents on the face of the Balance Sheet. Further, Note 6(C) of General Instructions for Preparation of Balance Sheet requires the following disclosures with regard to cash and bank balances:

- (a) Earmarked balances with banks (for e.g., for unpaid dividend) shall be separately stated;
- (b) Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments shall be disclosed separately;
- (c) Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated.

Above fund related to the client money for various projects which is earmarked for respective projects has been shown under the cash and cash equivalents- client fund instead of other bank balances. This has resulted into non-compliance of paragraph

8.1.16 of the Guidance Note on Division II - Ind AS Schedule III; and understatement of other bank balances-client fund and overstatement of cash and cash equivalents-client fund by Rs. 137,71,08,949 respectively.

The above fact may be confirmed; and, the comments, if any, be furnished to audit along with supporting document.

Management reply

Paragraph 8.1.16 of Guidance Note on Division II - Ind AS Schedule III read with paragraph 7 of Indian Accounting Standard (Ind AS) 7 – Statement of Cash Flows inter alia provides that bank balance and FDs having maturity of three months or less to be treated as cash and cash equivalent. Paragraph 8.1.16 further provides that bank balances other than that of the nature of cash and cash equivalent are to be disclosed below cash and cash equivalent.

In compliance to above requirement, the Company is consistently disclosing bank balance and FDs having maturity of three months or less as cash and cash equivalents and other bank balances not in the nature of cash and cash equivalent below cash and cash equivalent on the face of balance sheet.

One of the main businesses of the Company is project management consultancy (PMC). In PMC service, the Company also releases the payment on behalf of the client out of the funds provided by client. Funds so provided by clients are also disclosed separately as per the disclosure requirements of paragraph 8.1.16 read with paragraph 7 of Indian Accounting Standard (Ind AS) 7 i.e., as ‘cash and cash equivalents’ and ‘bank balance’. Since these funds are provided by client, and represented by corresponding liabilities in the financial statements, a suffix ‘client fund’ is attached. Suffix ‘client fund’ is only for the purpose of better disclosure and in no way should be construed as if any restriction is attached to withdrawal and use of these funds.

In view of the above, disclosure of fund of Rs. 137,71,08,949 as ‘cash and cash equivalent-client fund’ is in compliance with Ind AS 7 read with paragraph 8.1.16 of Schedule III of the Companies Act, 2013.”

Observation 2

“Significant Accounting Policies - Cash and Cash Equivalents (Note No.1.15)

As per above note, cash comprises cash on hand and demand deposits with banks. Cash equivalents are short term deposits with an original maturity of three months or less from the date of acquisitions which are readily convertible into known amounts of cash and be subject to an insignificant risk of change in value. Cash and cash equivalents consist of balances with banks which are unrestricted for withdrawal and usage.

During audit scrutiny, it was observed that the Company has shown cash and cash equivalents – clients fund (Note No.1.08) amounting Rs. 137.71 crore under cash and cash equivalents which belongs to clients, hence, the same is restricted for withdrawal and usage. Hence, the significant accounting policy (Note No.1.15) is deficient to that extent.

The above fact may be confirmed; and, the comments, if any, be furnished to audit along with supporting document.

Management reply

It is submitted that on the face of balance sheet, the Company has disclosed cash and cash equivalent under 2 items i.e., cash and cash equivalent – owned fund and cash and cash equivalent – client fund. This disclosure is being made consistently by the Company to meet the following objectives:

(i) to meet the compliance requirement of paragraph 8.1.16 of Guidance Note on Schedule III read with paragraph 7 of Ind AS 7 – Statement of Cash Flows, which inter alia provides that bank balance and FDs having maturity of three months or less to be treated as cash and cash equivalent and

(ii) to make user of the financial statements understand that the Company is keeping funds (cash and cash equivalents) on behalf of clients also.

As submitted in reply to observation 1 above, funds received from clients, which are kept in banks / FDs having maturity of less than 3 months, are readily available for the purpose for which these funds are received and there is no restriction on withdrawal and usage of these funds. Therefore, cash and cash equivalent, whether for own funds or held in the name of clients are neither restricted for withdrawal nor for usage of fund.

Thus, separate disclosure of owned fund & client fund is primarily to give more clarity to user and not to indicate any restriction on these funds, which is not there at all. As such Accounting Policy No. 1.15 on cash and cash equivalent is appropriate.”

6. As can be seen that contention of audit in observation 1 is that funds received from client should be shown as ‘bank balance’ instead of ‘cash and cash equivalents’; however management is of the view that disclosure has been made strictly in line with paragraph 8.1.16 of the Guidance Note on Division II - Ind AS Schedule III to the Companies Act, 2013 read with paragraph 7 of Ind AS 7, ‘Statement of Cash Flows’, which, inter alia, provides that bank balance and FDs having maturity of three months or less are to be treated as cash and cash equivalent, since client funds in question are kept in bank or FDs having maturity of 3 months and less. As regard to observation 2, audit is of the view that restriction on client funds has not been disclosed in the accounting policy, whereas management is of the view that disclosure of cash and cash equivalent in two categories i.e., client fund and owned fund, itself provides the adequate information to the reader of financial statements. Further, it can also be seen that funds held on behalf of client is also not considered for the purpose of cash flow statement.

B. Query

7. In view of above, the opinion of the Expert Advisory Committee is sought as to whether significant accounting policy of the Company as reproduced above, disclosure made in respect of cash and cash equivalents related to client funds, and not considering the client funds in the Statement of Cash Flows are appropriate and in compliance with Ind AS 7 read with Schedule III; and if not, what modification needs to be done?

C. Points considered by the Committee

8. The Committee notes that the basic issue raised by the querist relates to the presentation in the financial statements of funds received from the clients for making payment to contractor on their behalf. Such funds are kept in a separate bank account and are freely accessible on demand to the Company, in the process of rendering PMC services to the clients. The Committee has, therefore, considered only this issue and has not considered any other issue that may arise from the Facts of the Case, such as, accounting treatment of own funds, accounting for any interest received on clients' funds, accounting for payment made by the Company to the contractors engaged on behalf of the clients, accounting and presentation of deposits with banks or investments with maturity of more than three months, classification of bank balances as current or non-current, appropriateness of reportable segments being identified by the Company, whether there exists any principal-agency relationship between the clients and the Company, offsetting of the funds received from clients and the associated liabilities while presenting in the balance sheet, etc. Further, the opinion expressed hereinafter is purely from accounting perspective and not from legal perspective. Furthermore, the Committee wishes to point out that the Indian Accounting Standards referred to in the Opinion are the Indian Accounting Standards, notified under the Companies (Indian Accounting Standards) Rules, 2015, as revised or amended from time to time.

9. At the outset, the Committee notes from the Facts of the Case that the Company executes a number of projects on 'Deposit Works' basis on behalf of clients as project management consultant. Under this type of work, the Company engages contractor on behalf of a client and makes payment to the contractor out of the client's money, which is kept in designated bank accounts, opened and operated by the Company. Thus, it is understood that the terms of bank account contain no contractual restriction regarding access i.e. these funds are available on demand for use by the Company. However, as per contracts with the clients/customers, these funds are not to be used for normal business activities of the Company and any interest earned on such funds is also credited to the client's account. The Committee also notes that clients' funds in question are kept in bank or FDs having maturity of 3 months and less.

10. The Committee further notes the following requirements of Ind AS 7, 'Statement of Cash Flows' and the Guidance Note on Division II- Ind AS Schedule III to the Companies Act, 2013 (Revised January, 2022 Edition), issued by the ICAI (hereinafter referred to as 'the Guidance Note'):

Ind AS 7

“Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.”

“7 Cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes. For an investment to qualify as a cash equivalent it must be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition. Equity investments are excluded from cash equivalents unless they are, in substance, cash equivalents, for example in the case of preference shares

acquired within a short period of their maturity and with a specified redemption date.”

“45 An entity shall disclose the components of cash and cash equivalents and shall present a reconciliation of the amounts in its statement of cash flows with the equivalent items reported in the balance sheet.”

“Other disclosures

48 An entity shall disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the entity that are not available for use by the group².

49 There are various circumstances in which cash and cash equivalent balances held by an entity are not available for use by the group³. Examples include cash and cash equivalent balances held by a subsidiary that operates in a country where exchange controls or other legal restrictions apply when the balances are not available for general use by the parent or other subsidiaries.”

Guidance Note

“8.1.16. Cash and Bank Balances

(i) Cash and cash equivalents shall be classified as:

- (a) Balances with banks (of the nature of cash and cash equivalents);
- (b) Cheques, drafts on hand;
- (c) Cash on hand;
- (d) Others (specify nature).

(ii) Bank balances other than cash and cash equivalents as above, shall be disclosed below cash and cash equivalents on the face of the Balance Sheet

Further, Note 6(C) of General Instructions for Preparation of Balance Sheet requires the following disclosures with regard to cash and bank balances:

- (a) Earmarked balances with banks (for e.g., for unpaid dividend) shall be separately stated;
- (b) Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments shall be disclosed separately;
- (c) Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated.

Cash and cash equivalents is not defined in Ind AS Schedule III however, according to *Ind AS-7 Statement of Cash Flows*, Cash is defined to include cash on hand and demand deposits with banks. Cash Equivalents are defined as short term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.

² The requirements shall be equally applicable to the entities in case of separate financial statements also.

³ Ibid.

Ind AS 7 further explains that an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition. This would include term deposits with banks that have an original maturity of three months or less. However, bank balances (including term deposits) held as margin money or security against borrowings are neither in the nature of demand deposits, nor readily available for use by the company, and accordingly, do not meet the aforesaid definition of cash equivalents.

The disclosure regarding 'bank balances other than cash and cash equivalents' should include items such as Balances with banks held as margin money or security against borrowings, guarantees, etc. and bank deposits with original maturity of more than three months but less than 12 months.

Generally, there should not be a difference in the amount of cash and cash equivalent as per Ind AS 1 and as per Ind AS 7. ...”

From the above, the Committee notes that the cash equivalents are short-term, highly liquid investments with maturity of normally three months or less and which are readily convertible to a known amount of cash and subject to an insignificant risk of changes in value. The Committee notes that in the extant case, the funds deposited by clients in designated bank accounts are kept in current/flexi/ fixed deposit (FD) account(s) for a period of 3 months or less and are not subject to any risk of changes in value. Therefore, they meet the definition of cash and cash equivalents irrespective of the purpose for which such funds can be used by the Company. Further, paragraph 45 of Ind AS 7 states that “an entity shall disclose the components of cash and cash equivalents ...” and paragraphs 48 and 49 of Ind AS 7 require to disclose information about 'cash and cash equivalent' balances held by an entity that are not freely available for use and subject to certain restrictions with regard to usage of funds. Thus, it indicates that cash or cash equivalent can be subject to restrictions on use. Accordingly, the Committee is of the view that the restrictions on usage do not preclude an item from being classified as 'cash and cash equivalent' unless such restrictions change its nature in a way that it would no longer meet the definition of cash and cash equivalents. Hence, funds provided by the clients in the extant case should be classified as cash and cash equivalents as per Ind AS 7. The Committee also notes that the Guidance Note specifically states that generally, there should not be a difference in the amount of cash and cash equivalents as per Ind AS 1, 'Presentation of Financial Statements' and as per Ind AS 7. Therefore, the cash and cash equivalents presented as per the Statement of Cash Flows should also be presented under the similar head in the balance sheet prepared and presented as per the requirements of Ind AS 1 and Schedule III to the Companies Act, 2013.

11. With regard to presentation of cash and cash equivalents, the Committee notes from the requirements of the Guidance Note that cash and cash equivalents are to be classified into: (a) Balances with banks (of the nature of cash and cash equivalents); (b) Cheques, drafts on hand; (c) Cash on hand; (d) Others. Further, as per the General Instructions for Preparation of Balance Sheet, earmarked balances with banks and bank balances to the extent held for other commitments have to be separately stated/disclosed. Also, the requirements of paragraphs 48 and 49 of Ind AS 7, require to separately disclose along with the information about 'cash and cash equivalent' balances held by an entity that are not freely available for use by the group and are subject to certain restriction with regard to usage of funds along with management commentary.

Therefore, the Committee is of the view that the clients' funds in the extant case, although do not have repatriation restrictions or restrictions for use by the group as per paragraphs 48 and 49 of Ind AS 7 or held as margin money or security against borrowings, guarantees, etc., but these have to be used only for specific purposes and projects, as specified by the client and cannot be used generally as per the Company's own discretion and for use in other projects/activities; and thus have restrictions on uses. Therefore, these restrictions should be separately and adequately disclosed under the head 'cash and cash equivalents' only as per the requirements of Ind AS 7 and Schedule III to the Companies Act, 2013.

12. With regard to presentation in the Statement of Cash Flows, the Committee also notes the following requirement as contained in Ind AS 7:

“22 Cash flows arising from the following operating, investing or financing activities may be reported on a net basis:

(a) cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the entity; and ...”

From the above, the Committee notes that as per the requirements of Ind AS 7, cash flows on behalf of customers when they reflect the activities of the customer rather than those of the entity may be reported on a net basis. Therefore, the above requirements should also be complied with in respect of cash flows arising on behalf of clients in the extant case while presenting the Statement of Cash Flows.

D. Opinion

13. On the basis of the above and subject to paragraph 8 above, the Committee is of the opinion that the clients' funds lying in designated bank accounts should be considered as 'cash and cash equivalents' in the financial statements including the Statement of Cash Flows, as discussed in paragraph 10 above. Further, since clients' funds in the extant case, have to be used only for specific purposes and projects, as specified by the client and cannot be used generally as per the Company's own discretion and for use in other projects/activities and thus, have restrictions on uses, these restrictions should be separately and adequately disclosed under the head 'cash and cash equivalents' as per the requirements of Ind AS 7 and Schedule III to the Companies Act, 2013, as discussed in paragraph 11 above. Also, as per the requirements of paragraph 22 of Ind AS 7, cash flows on behalf of clients when they reflect the activities of the clients rather than those of the entity may be reported on a net basis, as discussed in paragraph 12 above in the Statement of Cash Flows.
