

Query No. 35

Subject: Treatment and presentation of Perpetual Loan under Ind AS framework.¹

A. Facts of the Case

1. A company (hereinafter referred to as ‘the Company’) is a Government of India (GoI) undertaking under the control of the Ministry of Defence, with 100% equity shareholding held by the GoI. The Company is primarily engaged in the construction and repair of ships and submarines, fulfilling the requirements of the defence and maritime sectors in India.

2. The Government of India sanctioned a financial restructuring (FR) package of ₹824.90 crores in financial year (F.Y.) 2010-11, which has been implemented by the Company, clearing its legacy liabilities (a copy of the sanction letter dated March 23, 2011 has been supplied by the querist for the perusal of the Committee). As part of this package:

- ₹ 452.68 crores were granted as aid for clearing outstanding liabilities, including bank dues, employee arrears, tax arrears, and other obligations.
- The existing government loan with accrued interest and guarantee fees amounting to ₹ 372.22 crores was converted into a loan in perpetuity with zero interest.

3. *Accounting Standards and Policies followed by the Company:*

The Company was preparing its financial statements in accordance with IGAAP, i.e., Accounting Standards notified under the Companies (Accounting Standards) Rules, 2021 (as amended) by the Ministry of Corporate Affairs (MCA), till F.Y. 2023-24. The accounting policies framed by the Company as per the IGAAP have been applied consistently over the years till F.Y. 2023-24. At its Board Meeting held on 27th November, 2024, the Board has accorded approval for implementation of Indian Accounting Standards (Ind AS) from F.Y. 2024-25. Accordingly, the Company is implementing Ind AS from F.Y. 2024-25 with preparation of its opening Ind AS Balance Sheet as on April 01, 2023, comparative Balance Sheet for F.Y. 23-24 and first Ind AS financial statements from F.Y. 2024-25.

4. *Issue – Classification of ₹ 372.22 crores Perpetual Loan in books of account by the Company.*

The loan of ₹ 372.22 crores was classified as ‘Long-term Borrowings’ under ‘Non-Current Liabilities’ in the balance sheet prepared as per IGAAP till F.Y. 2023-24. Of the total ₹ 541.21 crores in borrowings as of March 31, 2023, this loan in perpetuity constitutes a major portion, alongside another loan sanctioned in F.Y. 2018-19, which is repayable over 8 years with a 2-year moratorium.

5. The querist has informed the views of the Company as follows:

(a) *No Repayment Obligation:* The loan of ₹ 372.22 crores, sanctioned without interest or repayment terms, has no stipulated repayment schedule. This, in essence, positions the loan as an investment by the GoI, taking on the characteristics of equity.

¹ Opinion finalised by the Committee on 7.1.2025.

(b) *Controlling Interest*: The Company is wholly owned by the GoI, and the conversion of this loan into a perpetual one can be viewed as a strategic decision akin to a permanent financial contribution, similar to a promoter's equity investment. It mirrors the nature of shareholder funds, with no expectation of repayment.

(c) *Substance over Form*: The principle of 'substance over form', as outlined in Accounting Standard (AS) 1, 'Disclosure of Accounting Policies' suggests that the loan should be treated based on its economic substance rather than its legal form. Despite its legal designation as a loan, the absence of repayment obligations suggests that it functions as equity, warranting classification under shareholders' funds.

(d) *No Conditions for Fulfilment*: The Government's sanction does not impose any future repayment conditions or restrictions on further borrowings, or other typical loan covenants. This reinforces the argument for its treatment as an equity-like instrument.

B. Query

6. On the basis of above, the querist has sought the opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India on the following issues:

- (i) What is the treatment of perpetual loans under Ind AS?
- (ii) Under Ind AS, can the perpetual loan be classified as 'Equity'? If yes, please explain the recognition criteria, classification and presentation requirements surrounding perpetual loans under Ind AS.

C. Points considered by the Committee

7. The Committee notes that the basic issue raised by the querist relates to accounting treatment of perpetual loan under Ind AS. The Committee has therefore, considered only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, accounting for another loan sanctioned in F.Y. 2018-19, which is repayable over 8 years with a 2-year moratorium, accounting for funds amounting to Rs. 452.68 crores granted as grant-in-aid for clearing outstanding liabilities and obligations of the Company and payments made thereagainst for clearing the outstanding liabilities and obligations, adjustment for netting of interest receivable against interest payable, accounting under Accounting Standards (AS), notified under the Companies (Accounting Standards) Rules, 2021 including accounting treatment of perpetual loan, preparation of first Ind AS balance sheet and comparative figures for F.Y. 2023-24, transition to Ind AS and adjustments arising therefrom as well as disclosures required in first Ind AS financial statements, etc. Further, the Committee has expressed its opinion purely from the accounting perspective and not from the perspective of legal interpretation of sanction letter, 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.

8. At the outset, the Committee notes from the financial restructuring sanction letter of GoI dated March 23, 2011 as follows:

“ ...

- (a) By giving grants-in-aid amounting to Rs. 452.68 crores (Rupees four hundred fifty two crores and sixty eight lakhs) to clear the legal liabilities.
- (b) For converting the Government loans and interest and Government guarantee fee against Bank loan amounting to Rs. 372.22 crores (Rupees three hundred seventy two crores and twenty two lakhs) as loan in perpetuity with no interest.

2. As per the approval of the Government and advice of the Ministry of Finance, the above financial restructuring package of Rs. 824.90 crores will be implemented as follow:

SI. No.	Particulars	Amount as on 31.12.2009 (Rs. In Crore)	Effect to be given
1.	Government Loan	149.87	The existing principal amount of loan of Rs.149.87 crores (already outstanding in Government books) be converted as loan in perpetuity with no interest.
2.	Outstanding Interest payable to Government	157.37	The outstanding interest amounting to Rs.157.37 crores be provided as a fresh loan in perpetuity with no interest. However, this will be netted against interest receivable from the company. This will not involve cash outgo and therefore, will not make impact on the expenditure side.
3.	Government Guarantee Fee against Bank loan	64.98	Rs.64.98 crores as outstanding guarantee fee payable to the Government be converted as loan in perpetuity with no interest. This will not involve cash outgo and makes no impact on the expenditure celling.
4.	All other liabilities towards MAT, Corporate Tax Liability, One time Assistance for ongoing projects, implementation of VRS, liquidation of Bank dues, payment of statutory dues to Government of Andhra Pradesh, payment of	452.68	All these items required to be paid in full.

outstanding dues, custom duty, arrears etc.		
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...

5. The expenditure will be debitable to Major Head 2852 – Industries - 80.800, 03.01.50 for Grants-in-Aid and Major Head 6858 - Loan for Engineering Industries – 03.190, 03.03.55 for Loan in Perpetuity under Demand No.20 of the Ministry of Defence (Civil) for the financial year 2010-11. ”

From the above, the Committee notes that while Rs. 452.68 crores to clear the legal liabilities and obligations of the Company has been given as ‘grant-in-aid’ by the GoI, the term ‘grant-in-aid’ has not been used for the sanction of Rs. 372.22 crores; rather it has been granted as a fresh loan in perpetuity with no interest for existing outstanding GoI loans and interest thereon and outstanding guarantee fee paid by GoI against bank loans. The Committee also notes that the Company has no repayment obligation with regard to ‘loan in perpetuity.’ Further, the Committee notes that the Company was presenting the sanction of Rs. 372.22 crores as ‘long-term borrowings’ till the F.Y. 2023-24 prior to transition to Ind AS. Accordingly, in this context, the Committee has presumed that the Company has appropriately considered the same as not in the nature of government grant (forgivable loan) as per Ind AS 20, ‘Accounting for Government Grants and Disclosure of Government Assistance’ or under the erstwhile AS 12, ‘Accounting for Government Grants’. Therefore, it can be considered that the perpetual loan has been granted by the GoI not in the capacity of ‘Government’ as per Ind AS 20 or AS 12; rather the GoI while sanctioning the perpetual loan is acting in its capacity as 100% shareholder or owner.

9. With regard to the accounting for such a perpetual loan with no interest, the Committee notes the following requirements of Ind AS 32, ‘Financial Instruments: Presentation’ and Guidance Note on Division II- Ind AS Schedule III to the Companies Act, 2013 (Revised 2022):

Ind AS 32

“A *financial instrument* is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.”

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

(a) a contractual obligation :

(i) to deliver cash or another financial asset to another entity; or

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or

(b) a contract that will or may be settled in the entity’s own equity instruments and is:

(i) a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity’s own equity instruments; or

- (ii) **a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose, rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments. Apart from the aforesaid, the equity conversion option embedded in a convertible bond denominated in foreign currency to acquire a fixed number of the entity's own equity instruments is an equity instrument if the exercise price is fixed in any currency. Also, for these purposes the entity's own equity instruments do not include puttable financial instruments that are classified as equity instruments in accordance with paragraphs 16A and 16B, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 16C and 16D, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.**

As an exception, an instrument that meets the definition of a financial liability is classified as an equity instrument if it has all the features and meets the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D.

An *equity instrument* is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.”

“15 The issuer of a financial instrument shall classify the instrument, or its component parts, on initial recognition as a financial liability, a financial asset or an equity instrument in accordance with the substance of the contractual arrangement and the definitions of a financial liability, a financial asset and an equity instrument.

16 When an issuer applies the definitions in paragraph 11 to determine whether a financial instrument is an equity instrument rather than a financial liability, the instrument is an equity instrument if, and only if, both conditions (a) and (b) below are met.

- (a) The instrument includes no contractual obligation:
 - (i) to deliver cash or another financial asset to another entity; or
 - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the issuer.
- (b) If the instrument will or may be settled in the issuer's own equity instruments, it is:

- (i) a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or
- (ii) a derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments. ...”

“25 A financial instrument may require the entity to deliver cash or another financial asset, or otherwise to settle it in such a way that it would be a financial liability, in the event of the occurrence or non-occurrence of uncertain future events (or on the outcome of uncertain circumstances) that are beyond the control of both the issuer and the holder of the instrument, such as a change in a stock market index, consumer price index, interest rate or taxation requirements, or the issuer’s future revenues, net income or debt-to-equity ratio. The issuer of such an instrument does not have the unconditional right to avoid delivering cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability). Therefore, it is a financial liability of the issuer unless:

- (a) ...
- (b) the issuer can be required to settle the obligation in cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability) only in the event of liquidation of the issuer; or
- (c) ...”

“AG7 A contractual right or contractual obligation to receive, deliver or exchange financial instruments is itself a financial instrument. A chain of contractual rights or contractual obligations meets the definition of a financial instrument if it will ultimately lead to the receipt or payment of cash or to the acquisition or issue of an equity instrument.”

“AG13 Examples of equity instruments include non-puttable ordinary shares, some puttable instruments (see paragraphs 16A and 16B), some instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation (see paragraphs 16C and 16D), some types of preference shares (see paragraphs AG25 and AG26), and warrants or written call options that allow the holder to subscribe for or purchase a fixed number of non-puttable ordinary shares in the issuing entity in exchange for a fixed amount of cash or another financial asset. An entity’s obligation to issue or purchase a fixed number of its own equity instruments in exchange for a fixed amount of cash or another financial asset is an equity instrument of the entity (except as stated in paragraph 22A). However, if such a contract contains an obligation for the entity to pay cash or another financial asset (other than a contract classified as equity in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D), it also gives rise to a liability for the present value of the redemption amount (see paragraph AG27(a)). An issuer of non-puttable ordinary shares assumes a liability when it formally acts to make a distribution and becomes legally obliged to the shareholders to do so. This may be the case following the declaration of a dividend or when the entity is being wound up and

any assets remaining after the satisfaction of liabilities become distributable to shareholders.”

Guidance Note on Division II- Ind AS Schedule III

“8.2.1.6. ... Ind AS 32 defines an equity instrument as “*any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities*”. The accounting definition of ‘Equity’ is principle based as compared to the legal definition of ‘Equity’ or ‘Share’, such that any contract that evidences residual interest in an entity’s net asset is termed as ‘Equity’ irrespective of whether it is legally recognized as a ‘Share’ or not. Accordingly, all instruments (including convertible preference shares and convertible debentures) that meet the definition of ‘Equity’ as per Ind AS 32 in its entirety and when they do not have any component of liability, should be considered as having the nature of ‘Equity’ for the purpose of Ind AS Schedule III. Such instruments shall be termed as ‘Instruments entirely equity in nature’.”

The Committee notes from the above that a financial instrument is required to be classified on initial recognition as a financial liability, a financial asset or an equity instrument in accordance with the substance of the contractual arrangement and the definitions of a financial liability, a financial asset and an equity instrument in Ind AS 32. The Committee further notes that the key features in determining whether a financial instrument is a financial liability are (a) the existence of a contractual obligation of one party (issuer) to deliver cash or another financial asset to another party (holder of the instrument), (b) existence of contractual obligation to exchange financial assets or financial liabilities with the holder under conditions that are potentially unfavourable to the issuer, or (c) if the instrument will or may be settled in the issuer’s own equity instruments, whether it is a derivative or non-derivative instrument and whether it includes any contractual obligation for the issuer to deliver a variable number of its own equity instruments. When an instrument requires mandatory redemption (in terms of principal or interest) by the issuer for a fixed or determinable amount, a contractual obligation to deliver cash at redemption exists and, therefore, the instrument includes, and is presented as, a financial liability. The Committee also notes from the requirements of the Guidance Note that any contract that evidences residual interest in an entity’s net asset is termed as ‘Equity’ irrespective of whether it is legally recognised as a ‘Share’ or not; and that all instruments that meet the definition of ‘Equity’ as per Ind AS 32 in its entirety and when they do not have any component of liability, should be considered as having the nature of ‘Equity’ and shall be termed as ‘Instruments entirely equity in nature’.

10. In the extant case, the Committee notes that since the liabilities of Rs. 372.22 crores have been converted in a perpetual loan with no interest payment or repayment of principal amount within a specified time, there is neither a contractual obligation to pay cash or other financial asset nor to exchange financial assets or financial liabilities with the holder under conditions that are potentially unfavourable to the Company, as envisaged in the definition of ‘financial liability’ as per Ind AS 32. Further, since there is no fact in the extant case suggesting that the loan will or may be settled in the issuer’s own equity instruments, the evaluation related to conversion in entity’s own equity instruments is not applicable. Accordingly, the Committee is of the view that the perpetual loan in the extant case does not meet the definition of financial liability as per the requirements of Ind AS 32.

Furthermore, since the perpetual loan is not to be settled in the Company’s own equity instruments and as discussed above, neither there is a contractual obligation to deliver cash or

another financial asset to another entity nor to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the Company, the perpetual loan fulfills the conditions of an equity instrument as per paragraph 16 of Ind AS 32. Therefore, as per the requirements of the Guidance Note on Schedule III, the perpetual loan representing a contract or instrument evidencing residual interest in the Company's net assets should be considered as having the nature of 'Equity' and shall be termed as 'Instruments entirely equity in nature' in the financial statements of the Company.

11. With regard to presentation of the same in the financial statements, the Committee notes the requirements of Ind AS 1, 'Presentation of Financial Statements' and Guidance Note on Division II- Ind AS Schedule III to the Companies Act, 2013 (Revised 2022) as follows:

Ind AS 1

“Statement of changes in equity

Information to be presented in the statement of changes in equity

106 An entity shall present a statement of changes in equity as required by paragraph 10. The statement of changes in equity includes the following information:

...

(d) for each component of equity, a reconciliation between the carrying amount at the beginning and the end of the period, separately (as a minimum) disclosing changes resulting from:

(i) ...

...

(iii) *transactions with owners in their capacity as owners, showing separately contributions by and distributions to owners and ...*”

“109 Changes in an entity's equity between the beginning and the end of the reporting period reflect the increase or decrease in its net assets during the period. Except for changes resulting from transactions with owners in their capacity as owners (*such as equity contributions, reacquisitions of the entity's own equity instruments and dividends*) and transaction costs directly related to such transactions, the overall change in equity during a period represents the total amount of income and expense, including gains and losses, generated by the entity's activities during that period.”

(Emphasis supplied by the Committee.)

Guidance Note on Division II- Ind AS Schedule III

“8.2.1.7. Instruments entirely equity in nature, may be presented as a separate line item on the face of the Balance Sheet under 'Equity' after 'Equity Share Capital' but before 'Other Equity', as shown below:

Name of the Company.....

Balance Sheet as at.....

(Rupees in.....)

	Particulars	Note No.	Figures as at the end of current reporting period	Figures as at the end of previous reporting period
	EQUITY AND LIABILITIES			
	Equity			
	(a) Equity Share Capital			
	(b) Instruments entirely equity in nature			
	(c) Other Equity			

In the Statement of Changes in Equity, the reconciliation for instruments entirely equity in nature should be presented as below:

STATEMENT OF CHANGES IN EQUITY

Name of the Company.....

(Rupees in.....)

A. Equity Share Capital

...

B. Instruments entirely equity in nature *

(a) Compulsorily Convertible Preference Shares

...

(c) [Instrument] (Any other instrument entirely equity in nature)

(1) Current reporting period

Balance at the beginning of the current reporting period	Changes in [Instrument] due to prior period errors	Restated balance at the beginning of the current reporting period	Changes in [Instrument] during the current year	Balance at the end of the current reporting period

(2) Previous reporting period

Balance at the beginning of	Changes in [Instrument]	Restated balance at the beginning of	Changes in [Instrument] during the	Balance at the end of the previous

the previous reporting period	due to prior period errors	the previous reporting period	previous year	reporting period

...

** It may be emphasized that whether an instrument qualifies in its entirety for classification as 'equity' depends on the terms and conditions associated with it, evaluated based on the criteria given in para 16 of Ind AS 32. It is assumed that Compulsorily Convertible Preference Shares and Compulsorily Convertible Debentures in the above illustrative disclosure qualify for classification as entirely equity however, companies should assess terms and conditions specific to their instruments for deciding whether they are entirely equity in nature."*

From the above, the Committee is of the view that the Company should comply with the above-reproduced and other presentation requirements of Ind AS 1 and the Guidance Note on Division II- Ind AS Schedule III to the Companies Act, 2013, issued by the ICAI with regard to perpetual loan in the extant case.

D. Opinion

12. On the basis of above, the Committee is of the following opinion on issues raised in paragraph 6 above:

- (i) & (ii) As per the requirements of Ind AS 32 and the Guidance Note on Schedule III to the Companies Act, 2013, the perpetual loan in the extant case should be considered as having the nature of 'Equity' and shall be termed as 'Instruments entirely equity in nature' in the financial statements of the Company, as discussed in paragraphs 9 and 10 above. Further, the Company should comply with the presentation requirements of Ind AS 1 and the Guidance Note on Division II- Ind AS Schedule III to the Companies Act, 2013, issued by the ICAI in this regard, as discussed in paragraph 11 above.
