

Query No. 38

Subject: *Disclosure of abandonment fund of a third-party temporarily collected by the Company for future repatriation under Ind AS framework.*¹

A. Facts of the Case

1. A public limited company (hereinafter referred to as ‘the Company’), which is a wholly owned subsidiary of a listed government company is in the business of exploration and production of oil and gas and other hydrocarbon related activities outside India. The Company operates overseas projects directly and/or through subsidiaries, by participation in various joint arrangements and investment in joint ventures/associates.

2. The Company joined Project S, an unincorporated joint venture, located in a foreign country (host country) in July 2001 by acquiring 20% participating interest (PI) therein. Project S is in the development and production phase. The other consortium members to Project S being X (the Operator) with 30% PI, Y with 30% PI, and subsidiaries Z with 20% PI i.e. (Z1 with 11.5% and Z2 with 8.5%). Project S was managed and operated by the Operator on behalf of the consortium members as per the underlying Production Sharing Agreement (PSA or Agreement) executed between the consortium members and the Government of the host country (host Government) and the relation among the consortium members was governed by Joint Operating Agreement (JOA) and Crude-offtake Agreement executed amongst the consortium partners. (The PSA and JOA of Project S have been supplied separately by the querist for the perusal of the Committee.)

3. As per the provisions of Article XX of the PSA, the abandonment fund was created to finance the cost estimate of the abandonment plan by the consortium members, whereby foreign partners including the Company were to regularly contribute in proportion to the PI. In accordance with the Portfolio Investment Guidelines provided in Abandonment Funding Agreement entered into between the Foreign Parties of the Consortium and approved Foreign Party Administrator (FPA), the Company had been contributing its share to the abandonment fund managed by the FPA, based overseas.

4. In accordance with Ind AS 111, ‘Joint Arrangements’, the Company had assessed Project S as a joint operation and accounted for its share of PI of the assets, liabilities, revenues and expenses by way of proportionate consolidation. Till the period ended September 30, 2022, the Company in its financial statements incorporated its PI in assets, liabilities, revenues and expenses of the project based on the Joint Interest Billing (JIB) received from the Operator.

5. In February 2022, due to special operations of the host country, various nations and international organisations on the plea of causing geo-political concerns, imposed several economic sanctions on the host country.

6. On October 7, 2022, in connection with restrictive measures imposed due to the sanctions, the Executive Head of the host country’s Government promulgated a decree (‘Decree’), titled ‘On the application of additional special economic measures in the fuel and energy sector in connection with the unfriendly actions of certain foreign states and international organisations’. Subsequently, the host Government also notified a Resolution

¹ Opinion finalised by the Committee on 8.2.2025.

dated October 12, 2022. (A copy of the Decree and Government Resolution have been supplied separately by the querist for the perusal of the Committee). In terms of the said Decree and the Government Resolution, a new limited liability company, namely, S-1 LLC was incorporated by the host Government on October 14, 2022. All rights, assets and obligations of the consortium, provided under the PSA, including the rights and obligations of the operator, were transferred to the S-1 LLC.

7. Further, the sub-paragraph (j) of paragraph 1 of Decree of the President of the host Government dated October 7, 2022 provided that abandonment fund accumulated by foreign parties of the consortium with the FPA shall be immediately credited by them to the bank account of S-1 LLC.

8. Sub-paragraph (e) of paragraph 1 of the Decree provided that foreign partners shall, within one month after establishment of S-1 LLC, submit to the host Government, notifications of their consent to take ownership of shares in the charter capital of the Company in proportion to the shares owned by each of them under the PSA.

9. To protect its economic interest in Project S, the Company submitted notice of its consent for ownership of 20% PI in S-1 LLC pursuant to the Decree to the host Government on 8th November 2022. The host Government, vide its order dated November 9, 2022, directed S-1 LLC for transfer of 20 percent of the share in the authorised capital of S-1 LLC to the Company. The transfer was conditional to fulfillment of sub-paragraph (j) of paragraph 1 of the Decree.

10. Since the rights and obligations of consortium partners under the PSA were transferred to S-1 LLC, the Company carried out accounting for the transition considering that the project may no longer be considered as a joint operation and as such, the Company may not be able to account for its proportionate share of assets and liabilities relating to the S-1 project.

11. Accordingly, the Company transferred carrying value of assets, including accumulated abandonment fund, and liabilities pertaining to its PI in Project S as on transition date, viz. 14th October 2022 on net basis (i.e., carrying values of the assets net of carrying value of liabilities pertaining to the project previously accounted for by the Company on proportionate basis) to deemed investment under the head Investments in JV/Associates with nomenclature 'Investment Pending Proportionate Ownership Interest in Equity of S-1 LLC'. The investment was identified as deemed investment, pending allotment of shares on fulfillment of condition precedent, i.e. transferring its share in the accumulated abandonment fund to S-1 LLC.

12. On account of the sanctions on the host Government and restrictions imposed on banking transactions with the bank of S-1 LLC, it was not a practical proposition to transfer the Company's share in the abandonment fund with FPA to S-1 LLC.

13. To facilitate the transfer, ensuring compliances with the applicable sanctions imposed by applicable jurisdictions, the Company requested a specific permission of the Reserve Bank of India (RBI) to open a US Dollar bank account for receiving the abandonment fund from FPA for discharging its abandonment liability obligation towards S-1 LLC (the transaction) (a copy of the request letter has been supplied separately by the querist for the perusal of the Committee). The permission requested, mentioned that the fund amount received will be kept separate for transfer to S-1 LLC and not be commingled with the Company's funds. Further, it

also mentioned that the accumulated amounts with interest will be utilised towards discharge of the abandonment liability obligations.

14. RBI conveyed its no-objection for opening of USD Foreign Currency Account (FCA) with the specific bank for the purpose specified in the request letter and that the account shall be closed after the transaction is completed. (A copy of the RBI approval has been supplied separately by the querist for the perusal of the Committee.)

15. Considering the approval conveyed by the RBI, the Company received its share of the accumulated abandonment fund from the FPA on April 5th and 6th, 2023 in the specific bank account.

16. On receipt of the accumulated abandonment fund in the specified bank account, a liability for an obligation to transfer the balance in the specified bank account to S-1 LLC was recognised in the books of account by the Company.

17. Due to the continuing economic sanctions on the host country, the Company has not been able to transfer the funds from the specified bank account to the bank account of S-1 LLC. Meanwhile, the fund balance in the specified bank had accreted considering the interest income accrued on the deposits. As per the extant provisions under income tax law, tax at source has also been deducted from the interest accrued on such deposits.

18. In the standalone financial statements for the year ended March 31, 2024, the following was reported by the Company on account of the liability towards sum payable to S-1 LLC and for sum held in the specific bank account:

- In Note No. 25 (Other Financial Liabilities), the Company, inter alia, presented Liability to S-1 LLC net of the funds received and held by it in separate bank account in the following manner:

(₹ in million)

Particulars	As at March 31, 2024	
	Non-current	Current
Liability for transferring abandonment fund	-	52,720.33
Less: Abandonment fund held on behalf of S-1 LCC (Refer note 55 (b))	-	52,720.33

- In Note 55 (b), the Company, inter alia, provided the following disclosure in respect of the abandonment fund:

“The Company has received its share of the accumulated abandonment fund from the Foreign Party Administrator on 5th & 6th April, 2023. The Company is in the process of completing transfer of its share of abandonment fund to S-1 LLC to fulfil the condition precedent. Due to restrictions on banks of host country, the Company is in discussion with Government of the host country and S-1 LLC for identifying likely alternatives to transfer the abandonment fund for fulfilling the condition precedent. Interest accrued on above fund along with the TDS thereon is due to S-1 LLC. During the year, interest income earned was USD 32.83 million (INR 3486.17 million), out of which TDS amounting to USD 1.8 million (INR 150.02 million) was deducted. As on 31st March 2024, an amount of USD 630.64 million (₹ 52,570.31 million) which is the amount after deduction of TDS on interest earned, is held by the Company on behalf of S-1 LLC, in a special purpose bank account opened with permission from

the Reserve Bank of India. In view of the substance of the transaction, the amount of abandonment fund liability has been offset with the related abandonment assets held by the Company on behalf of S-1 LLC (Refer Note 25).”

Issue in Question:

19. During supplementary audit by Comptroller and Auditor General of India (C&AG) on the financial statements of the Company for the financial year (F.Y.) 2023-24, the observations raised on the Company in respect of the abandonment fund reported as follows:

- The Company has neither included the amount deposited in the separate bank account/term deposits in its bank balances nor disclosed this figure in the Statement of Cash Flows. Rather, this amount has been set off with the corresponding liability towards S-1 LLC.
- Though the bank account has been opened with specific permission from RBI, the bank account is in the name of the Company as it is the custodian of this amount till transfer. The Company has shifted this amount to interest bearing term deposits and the Bank has also deducted tax at source against the interest income which is being paid by the Company. Thus, essentially the amount deposited in the bank is in the name of the Company and is the custodian of this fund.
- The Company has been considering various options to discharge the abandonment liability. In case of exercising any of such options, the amount deposited in the term deposits will then be available at the disposal of the Company.
- Also, there is no clarity as to whether or not the amount of interest that the Company has earned on this fund has to be transferred to S-1 LLC along with the amount of abandonment fund.

20. Therefore, as per C&AG, it was not justified to set-off the amount deposited in the bank account/term deposits with the corresponding liability which is not certain.

21. The auditors also noted that the Company has set-off the liability with bank deposits/term deposits in the Notes to financial statements (Note No. 25) while no information regarding this transaction has been given on the face of the Balance Sheet. The amount involved in this transaction is material and hence, the same should have either been set-off on the face of the Balance Sheet or the bank account and liability should have been shown separately in the Balance Sheet at their respective places.

22. Lastly, the auditors observed that the amount of liability and asset should have been recorded as Rs. 52,570.31 million instead of Rs. 52,720.33 million as the difference (Rs. 150.02 million) in these two figures is for TDS which is not payable to S-1 LLC but to the Income-tax Department.

Company's Perspective:

23. C&AG observation in respect of the issue raises the following concerns:

- (i) The Company should have presented the fund received from FPA as part of 'Cash and Cash Equivalents' and the Company's obligation to transfer the amount to S-

1 LLC as financial liability separately in the Balance Sheet instead of offsetting these items (Permissibility of Offsetting);

- (ii) Set-off on the face of the Balance Sheet necessitated even though it has been appropriately presented in the Notes to Accounts (Place of Presentation/Offsetting); and
- (iii) Correctness of recognition of the liability excluding TDS on interest earned (Measurement of items).

24. The Company's perspective in respect of each of the above issues is submitted in the following paragraphs:

Permissibility of Offsetting:

25. The Decree mandated transfer of all rights, assets and obligations of the erstwhile consortium to a new limited liability company, S-1 LLC and warranted transfer of the accumulated abandonment fund contributed by the foreign partners, including the Company, to the bank account of S-1 LLC. It is imperative to note that the fund was primarily created for meeting the abandonment liability of the erstwhile Project S. Since all rights, assets and obligations were transferred to S-1 LLC, after the Decree, the utilisation of the fund to discharge the abandonment liability is the responsibility of S-1 LLC and not the foreign partners. The RBI's specific approval for opening the bank account was also for the sole purpose of receiving the funds and transferring it to S-1 LLC. Thus, the obligation of transferring the fund to S-1 LLC is embedded with the abandonment fund received by the Company.

26. Though the legal form of the special bank account requires it to be identified in the name of the Company, the economic substance of the bank account is such that the funds lying therein are temporarily received by the Company only as a custodian with the ultimate obligation of transferring the funds to S-1 LLC. The right over the fund vests with S-1 LLC after the Decree. Since the day S-1 LLC came into being after the Decree, the abandonment fund was meant to be transferred to the bank account of S-1 LLC by the FPA. However, due to sanction linked restrictions, transfer of funds by FPA to the bank account of S-1 LLC being impracticable, it was necessitated to first receive the funds in a separate bank account for transferring the same along with accretions thereon to S-1 LLC, ensuring compliances with applicable sanctions imposed by applicable jurisdictions.

27. Paragraph 33 of Ind AS 1, 'Presentation of Financial Statements' inter alia provides that offsetting in the statement of profit and loss or balance sheet, except when offsetting reflects the substance of the transaction or other event, detracts from the ability of users both to understand the transactions, other events and conditions that have occurred and to assess the entity's future cash flows. The Company, to highlight the real substance of the transaction, has grouped the balance in the specified bank account with the liability for transferring abandonment fund (Current Liabilities-Other Financial Liabilities) towards S-1 LLC under Note No. 25 distinctly.

28. Reference has been invited by the querist to the Conceptual Framework for Financial Reporting under Indian Accounting Standards (Conceptual Framework), issued by the Institute of Chartered Accountants of India (ICAI), which defines an 'asset' as a present economic

resource controlled by the entity as a result of past events and states the following three necessary aspects:

- a. Right of the entity over the economic resource,
- b. Potential to produce economic benefits, and
- c. Control of economic resource by the entity

Further, as per the Conceptual Framework, 'Control' links an economic resource to an entity. Assessing whether control exists helps to identify the economic resource for which the entity accounts for. The following extracts of the paragraphs on the control aspect have been highlighted by the querist in the current context:

4.20: An entity controls an economic resource if it has the present ability to direct the use of economic resource and obtain the economic benefits that may flow from it. Control includes the present ability to prevent other parties from directing the use of the economic resource and from obtaining the economic benefits that may flow from it.

4.23: For an entity to control an economic resource, the future economic benefits from the resource must flow to the entity either directly or indirectly rather than to any other party.

4.25: (Inter alia) If an agent has custody of an economic resource controlled by the principal, that economic resource is not an asset of the agent.

From the above, the Company understands that the funds received including accretions (interest accrued) in a special purpose bank account, which the Company is overseeing for onwards transfer to S-1 LLC do not qualify as an asset of the Company because:

- The Company is holding the funds as a custodian for transfer to S-1 LLC considering the sanctions.
- The funds and accretions (interest income) thereon will be transferred to S-1 LLC and not to the Company.

29. In respect of the offsetting of a financial asset and financial liability, paragraph 42 of Ind AS 32, 'Financial Instruments: Presentation' provides as follows:

“42 A financial asset and a financial liability shall be offset and the net amount presented in the balance sheet when, and only when, an entity:

- (a) currently has a legally enforceable right to set off the recognised amounts; and**
- (b) intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.**

...”

30. Paragraph 45 of Ind AS 32 inter alia provides that “a right of set-off is a debtor’s legal right, by contract or otherwise, to settle or otherwise eliminate all or a portion of an amount due to a creditor by applying against that amount an amount due from the creditor”. Thus, it suggests that the offsetting can be done if the financial asset is due from, and the financial liability of the entity is due to the same counter-party. However, paragraph 45 also creates an exception that in unusual circumstances, a debtor may have a legal right to apply an amount due from a third

party against the amount due to a creditor provided that there is an agreement between the three parties that clearly establishes the debtor's right of set-off. Therefore, in unusual circumstances, like the present one, offsetting can be done even if financial asset is due from third party against the financial liability due to another party provided that there is an agreement among the parties that establishes right of set-off. Paragraph 45 states that such right of set-off may be by contract or otherwise i.e., by way of a constructive agreement. Paragraph 45 also states that because the right of set-off is a legal right, the conditions supporting the right may vary from one legal jurisdiction to another and the laws applicable to the relationships between the parties need to be considered.

31. In the present case, there is a constructive agreement among all the three parties viz. the bank being the counter-party for the financial asset (abandonment fund parked in specific bank accounts/deposits), the Company and S-1 LLC to whom the financial liability of the Company is due. Specific approval from the RBI mandates the specified FCA to be utilised only for the specific purpose of discharging the abandonment liability obligation towards S-1 LLC.

32. Further, the Company always had the intention of settling the abandonment liability/obligation towards S-1 LLC, utilising the abandonment fund lying in bank accounts/deposits simultaneously. Therefore, as per the querist, in terms of paragraph 43 of Ind AS 32, the Company is required to present the financial asset and financial liability on a net basis as doing so reflects the Company's true cash flows from the transaction. As per the existing regulatory position emanating from the approval from the RBI, the funds are exclusively tied for discharge of the obligation towards S-1 LLC and the special purpose bank account will also be closed on discharge of the obligation through payment of the funds to S-1 LLC.

33. In view of the foregoing, considering the substance of the transaction, in the spirit of Ind AS 1 and specific provisions of Ind AS 32 for offsetting, faithful representation of the transaction would be to group the liability to transfer the fund to S-1 LLC and the associated fund lying in the special purpose account and present on a net basis with a suitable disclosure. Disclosure of the balances on net basis with separate line items (within 'Other Financial Liabilities' Note) being identified will assist the users of the general purpose financial statements in identifying the substance of the transaction and understanding the true financial position of the Company. Presenting the liability to transfer to S-1 LLC and the balance lying in special purpose account separately would unduly overstate the assets and liabilities and would not be a faithful representation of the financial status and the cash flows position of the Company, causing misstatement to the users of general purpose financial statements.

Place of Presentation/ Offsetting:

34. As regards the place of presentation of offsetting, i.e., whether on the face of the Balance Sheet or in the Notes, provisions of paragraph 54 to 58 of Ind AS 1 have been referred to by the querist, which state that this Standard does not prescribe the order or format in which an entity presents items and that an entity shall present additional line items, headings and subtotals in the balance sheet when such presentation is relevant to an understanding of the entity's financial position. The provisions also state that the entity makes the judgement about whether to present additional items separately on the basis of an assessment of the nature and liquidity of assets, the function of assets within the entity and the amounts, nature and timing of liabilities.

From the above, the Company understands that contention of C&AG on disclosure of the information regarding the transaction on the face of the balance sheet and presentation of the offsetting on the face of the Balance Sheet is not mandated by the Standard. Paragraph 32 of the Standards speaks of 'Offsetting in the statement of profit and loss or balance sheet' and not on the face of profit and loss or balance sheet.

Presentation of additional information is a matter of the entity's judgement having regard to the materiality and relevance for the users of general purpose financial statements. In respect of the abandonment fund and the liability to transfer it to S-1 LLC, the Company has appropriately and distinctly presented the transaction in the Note by way of separate line items, further drawing attention to a detailed explanatory Note provided under 'Other Notes' for understanding of the users.

Measurement of items:

35. As regards the measurement of amount of liability to pay abandonment fund to S-1 LLC, the querist has highlighted that the interest accrued on the abandonment fund bank account/deposit is not an income of the Company and therefore, TDS on such interest is also not a tax asset of the Company. TDS is a method to collect income tax directly from the earnings; since the income prima facie does not relate to the Company, TDS on such income is also not related to the Company. Therefore, considering the incidence of the transaction, since the abandonment fund belongs to S-1 LLC ab initio, any accretion thereon in the form of interest also belong to S-1 LLC. Therefore, the Company has measured its liability of paying the amount of abandonment fund to S-1 LLC including TDS on the interest accrued on the fund.

B. Query

36. In view of the specific facts of the case and position of financial reporting framework as brought out above, opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India is sought on the following:

- (i) Whether the Company, considering the substance of the transaction, has correctly grouped the liability for transferring abandonment fund to S-1 LLC and the abandonment fund held on behalf of S-1 LLC in the special purpose account, presenting them on a net basis.
- (ii) Whether disclosure of the information regarding the transaction shall be presented on the face of the balance sheet and whether the presentation of the offsetting on the face of the balance sheet is mandated by the Indian Accounting Standards.
- (iii) In case the opinion on query (i) and (ii) above is in dissent, what is the suggested presentation of the transaction in the financial statements (i.e. balance sheet, statement of profit and loss, statement of cash flows and notes)?
- (iv) The Company has correctly measured the amount of liability for transferring abandonment fund to S-1 LLC including TDS on interest accrued on the bank account/deposits wherein the fund has been maintained.

C. Points considered by the Committee

37. The Committee notes that the basic issues raised by the querist relate to presentation of ‘abandonment fund held in the special purpose account’ and ‘obligation to transfer the balance in the specified bank account to S-1 LLC’ in the balance sheet (separate financial statements) of the Company on net basis and measurement of liability (whether including TDS or on gross basis, i.e. without including TDS). The Committee has, therefore, considered only these issues and has not examined any other issue that may arise from the Facts of the Case, such as, accounting for joint arrangements and investment in joint ventures/associates including investment in S-1 LLC, accounting for transition from joint operation to joint venture, accounting in the consolidated financial statements of the Company, recognition of liability for transfer of abandonment funds including timing of recognition, accounting for assets, liabilities, revenues and expenses in the joint operation of Project S prior to incorporation of S-1 LLC, accounting for transactions between the Company and operator of S-1 LLC or the Company with S-1 LLC, detailed presentation in the Statement of Cash Flows as per Ind AS 7, ‘Statement of Cash Flows’, related party disclosures as per Companies Act and Ind AS, application of the requirements of Ind AS 109 for classification and measurement of financial liability in respect of liability towards S-1 LLC, whether the funds lying in the special purpose account (including interest credited) are equal to the abandonment liability in respect of S-1 LLC, appropriateness of using LIBOR rate, etc. The Committee has only examined the issue from accounting perspective and has not examined the regulatory or legal classification and implications, including those arising under Income-tax Act and Foreign Exchange Management Act, 1999 (FEMA), Production Sharing Agreement, Joint Operating Agreement, Crude-offtake Agreement, the Decree and Government Resolution, etc. The opinion expressed hereinafter is in the context of Indian Accounting Standards (Ind AS), notified under the Companies (Indian Accounting Standards) Rules, 2015 as amended or revised from time to time.

38. The Committee first examines the nature of ‘abandonment fund held in the special purpose account’ and ‘obligation to transfer the balance in the specified bank account to S-1 LLC’. In this regard, the Committee notes the following relevant clauses of the Production Sharing Agreement (PSA), Decree of host Government and the Request letter dated 28th February 2023 of the Company to the RBI:

Production Sharing Agreement

“Article XX

ABANDONMENT

...

20.3 Each Party of Consortium shall be responsible *for the accumulation of the funds to finance its respective participating interest share of the cost estimate of the abandonment plan* approved in the Development Program and Budget for each Development Area submitted under the provisions of Article XIV and any revisions agreed by the Authorized State Body and Consortium. *These funds shall be accumulated from amounts provided by each Party of Consortium from the sale of Cost Hydrocarbons received and interest as specified herein.* The Consortium shall establish an account for each Development Area (hereinafter Memorandum Abandonment Account) and begin making a monthly provision to the Memorandum Abandonment Account following the Initial Sale of Hydrocarbons. ...

Each Month the amount in the Memorandum Abandonment Account shall be increased by an amount equal to the sum that would have been earned had the amount of money equal to the sum total in the Memorandum Abandonment Account been invested at LIBOR and by the amount of the provision.

In the Month following the Month in which total Cost Hydrocarbons allowed under the Agreement first exceeds unrecovered Cost Recoverable Expenditures, Consortium shall begin receiving Cost Hydrocarbons to recover amounts accumulated in the Memorandum Abandonment Account. ... From that point on two types of accounts– a Memorandum Abandonment Account and an account for each Development Area (hereinafter Abandonment Account)–shall be maintained. The Memorandum Abandonment Account shall be maintained until the cost reflected in the abandonment provisions is fully recovered from Cost Hydrocarbons. ...

- 20.4 Each Month, ... the Memorandum Abandonment Account shall be increased by an amount equal to interest accrued at LIBOR on the balance in the Memorandum Abandonment Account ...
- 20.5 The Foreign Party Administrator shall be appointed by the Foreign Parties of Consortium ...and shall be an internationally recognized financial institution ...
- 20.6 ... *The Foreign Party Administrator shall invest all available funds received in financial instruments issued by financial institutions, corporations or governments meeting Acceptable Financial Standards, with maturities not to exceed the date at which the funds shall be required for abandonment and in accordance with portfolio investment guidelines issued by the Foreign Parties of Consortium to the Foreign Party Administrator. ... Actual gains or losses on the funds invested by the Foreign Party Administrator will be for the sole account of the Foreign Parties of Consortium. For the purposes of determining the amount of each Abandonment Account and the abandonment provision, the amount of the abandonment provisions paid to ... the Foreign Party Administrator shall be assumed to earn interest at LIBOR from the date of such provision as set forth in Exhibit "G" hereto. ...*
- 20.7 ...*Each Party of Consortium shall have the option to elect to provide adequate security in lieu of paying any amount owed under the provisions of this Article 20.7 or Article 20.3. Any amounts not paid into the Abandonment Account will accrue interest at LIBOR. The total security provided by each Party of Consortium must at all times cover the full amount of its respective share due to the Abandonment Account including the accrued interest. ...*
- 20.8 *At the conclusion of Hydrocarbon Operations in a Development Area, apart from the assignment of its title to all assets in such Development Area to the State under Article 20.1 hereof, each Party of Consortium shall within thirty (30) Days assure that its funds in the appropriate Abandonment Account equal its participating interest share of the total estimated abandonment cost. Such total estimated abandonment cost shall be in accordance with the latest approved abandonment plan. Each Party shall assign its rights to such Abandonment Account to the State.*

Consortium and each Party of Consortium shall have no further responsibilities or liabilities in regards to such Abandonment Account or operation or maintenance of such assets or their abandonment. ...”

Decree of host Government

“...the following special economic measures shall apply to these foreign entities or entities under their control:

...

(j) cash funds in the amount equal to the amount of monetary funds accumulated by the foreign parties of the Consortium in accordance with Article XX of the Agreement shall be immediately credited by them or other individuals by their order to the Company bank account. The Company shall open a liquidation statement to transfer these monetary funds in the bank authorized by the host Government. The funds credited to the liquidation statement shall be used for the purposes and in the manner prescribed by the Agreement”

Request letter dated 28th February 2023 of the Company to RBI states as follows:

“Vide Decree dt. 9th Nov 2022 (enclosed), host Govt. has communicated authorisation to transfer of 20% share in the S-1 LLC to the Company after transfer of accumulated funds towards abandonment fund as per the PSA provisions ... It may be mentioned that, as per the PSA provisions, funds for abandonment of the field were to be accumulated by the joint venture over field life whereby the foreign parties were required to contribute the amounts with foreign party administrator meeting the criteria as per the PSA and approved by the ... authorities.

J Bank, ..., is the foreign party administrator of the abandonment fund. The Company is required to ensure that funds equal to the amount accumulated with J Bank (attributable to the Company’s share in the liability) are transferred to the S-1 LLC...**Due to the prevailing geo-political situation and the developments thereafter, it is not a practical proposition to transfer the funds from J Bank to S-1 LLC.**

It has necessitated that the Company should first receive the funds in a segregated bank account ... The accumulated amounts with interest will be utilised towards discharge of the abandonment liability obligations. The same are to be kept separate for transfer to S-1 LLC and not comingled with the Company’s funds. ...”

(Emphasis supplied by the Committee.)

The Committee notes from the above that the Company as a Party of Consortium was responsible for the accumulation of the funds to finance its respective participating interest share of the estimated cost of the abandonment plan for the development area, which is administered by the Foreign Party Administrator (FPA), independently appointed by the Parties to the Consortium. As per the PSA, the FPA had to invest such funds in financial instruments while ensuring the interest rate at LIBOR, which alongwith the funds accumulated were to be used for abandonment of the Development Area, whereas actual gains or losses on the funds

invested by the FPA were for the sole account of the Foreign Parties of Consortium. Further, the Company had the option to elect to provide adequate security in lieu of paying any amount owed. Furthermore, as per PSA, only at the conclusion of Hydrocarbon Operations in the Development Area, each Party of Consortium was to assign its rights to such Abandonment Account to the State.

From this, the Committee understands that the Company just had to accumulate funds or any security in its place so as to ensure the availability of funds for abandonment purposes. The funds lying in Abandonment Account were not to be transferred to the Consortium/joint operation or the State till the conclusion of the hydrocarbon operations and any gain or loss on investment of funds (to the extent of the Company's share) belonged to the Company. Thus, it appears that till the funds were to be transferred on conclusion of hydrocarbon operations, the same were being administered and controlled by the parties to the Consortium including the Company (through FPA). However, due to transition from joint operation of hydrocarbon operations to joint venture (S-1 LLC), the monetary funds accumulated by the foreign parties of the Consortium in accordance with PSA are required to be immediately credited to the bank account of S-1 LLC as a condition to allotment of shares in S-1 LLC. Further, it also appears from the facts supplied that till the transition and change in the structure of joint arrangement, the Company was treating the funds lying in the abandonment account as part of its own assets. Therefore, the Committee is of the view that the control on the funds lying in the abandonment account (to the extent of its share) vested with the Company.

Subsequently, due to condition imposed by the host Government for transfer of funds, the Company requested the RBI to open a Special Purpose Foreign Currency Account in India to which the funds accumulated may be transferred for further transfer to the bank account of S-1 LLC. The Committee also notes from the facts supplied that such special account was opened on the request of the Company itself and the Company can shift/transfer funds from such bank account to term deposits etc. to earn interest on the funds accumulated. Thus, it appears that the Company has the present ability to direct the use of the funds and obtain the economic benefits that may flow from it. Therefore, with regard to the querist's contention that the funds received including accretions (interest accrued) in the special purpose bank account do not qualify as an asset of the Company, the Committee notes the definition of 'asset' and other related requirements of the Conceptual Framework for Financial Reporting under Indian Accounting Standards (Ind AS), issued by the ICAI, as reproduced below:

“Definition of an asset

- 4.3 An asset is a present economic resource controlled by the entity as a result of past events.
- 4.4 An economic resource is a right that has the potential to produce economic benefits.
- 4.5 This section discusses three aspects of those definitions:
 - (a) right (see paragraphs 4.6–4.13);
 - (b) potential to produce economic benefits (see paragraphs 4.14–4.18); and
 - (c) control (see paragraphs 4.19–4.25).

Right

- 4.6 Rights that have the potential to produce economic benefits take many forms, including:
- (a) rights that correspond to an obligation of another party (see paragraph 4.39), for example:
 - (i) rights to receive cash.
 - (ii) rights to receive goods or services.
 - (iii) rights to exchange economic resources with another party on favourable terms. Such rights include, for example, a forward contract to buy an economic resource on terms that are currently favourable or an option to buy an economic resource.
 - (iv) rights to benefit from an obligation of another party to transfer an economic resource if a specified uncertain future event occurs (see paragraph 4.37).
 - (b) rights that do not correspond to an obligation of another party, for example:
 - (i) rights over physical objects, such as property, plant and equipment or inventories. Examples of such rights are a right to use a physical object or a right to benefit from the residual value of a leased object.
 - (ii) rights to use intellectual property.”

“Potential to produce economic benefits

- 4.14 An economic resource is a right that has the potential to produce economic benefits. For that potential to exist, it does not need to be certain, or even likely, that the right will produce economic benefits. It is only necessary that the right already exists and that, in at least one circumstance, it would produce for the entity economic benefits beyond those available to all other parties.”

“Control

- 4.19 Control links an economic resource to an entity. Assessing whether control exists helps to identify the economic resource for which the entity accounts. For example, an entity may control a proportionate share in a property without controlling the rights arising from ownership of the entire property. In such cases, the entity’s asset is the share in the property, which it controls, not the rights arising from ownership of the entire property, which it does not control.
- 4.20 An entity controls an economic resource if it has the present ability to direct the use of the economic resource and obtain the economic benefits that may flow from it. Control includes the present ability to prevent other parties from directing the use of the economic resource and from obtaining the economic benefits that may flow from it. It follows that, if one party controls an economic resource, no other party controls that resource.”

From the above, the Committee is of the view that since in the extant case, as mentioned above, the Company has the present ability to direct the use of funds in the special purpose account and can obtain the benefits that may flow from it, such funds are controlled by the Company and fulfill the definition of an ‘asset’.

In this context, the Committee notes that while setting off these funds against financial liability as per the requirements of Ind AS 32, the Company also considers them as ‘financial asset’. Therefore, the Committee does not agree with the contention of the querist that the funds received including accretions (interest accrued) in the special purpose bank account, do not qualify as an asset of the Company.

39. Now, the Committee examines whether the financial asset in terms of bank balance in special purpose account can be set-off against the financial liability created for the contractual obligation to transfer/deliver such funds/cash as a condition for allotment of shares. In this regard, the Committee notes the following requirements of Ind AS 32, ‘Financial Instruments: Presentation’ and Basis for Conclusions to International Accounting Standard (IAS) 32 (corresponding international standard to Ind AS 32), issued by the International Accounting Standards Board:

“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**
- ...

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: ...”**

“42 A financial asset and a financial liability shall be offset and the net amount presented in the balance sheet when, and only when, an entity:

- (a) **currently has a legally enforceable right to set off the recognised amounts; and**
- (b) **intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.**

In accounting for a transfer of a financial asset that does not qualify for derecognition, the entity shall not offset the transferred asset and the associated liability (see Ind AS 109, paragraph 3.2.22)."

“45 A right of set-off is a debtor’s legal right, by contract or otherwise, to settle or otherwise eliminate all or a portion of an amount due to a creditor by applying against that amount an amount due from the creditor. In unusual circumstances, a debtor may have a legal right to apply an amount due from a third party against the amount due to a creditor provided that there is an agreement between the three parties that clearly establishes the debtor’s right of set-off. Because the right of set-off is a legal right, the conditions supporting the right may vary from one legal jurisdiction to another and the laws applicable to the relationships between the parties need to be considered.

46 The existence of an enforceable right to set off a financial asset and a financial liability affects the rights and obligations associated with a financial asset and a financial liability and may affect an entity’s exposure to credit and liquidity risk. However, the existence of the right, by itself, is not a sufficient basis for offsetting. In the absence of an intention to exercise the right or to settle simultaneously, the amount and timing of an entity’s future cash flows are not affected. When an entity intends to exercise the right or to settle simultaneously, presentation of the asset and liability on a net basis reflects more appropriately the amounts and timing of the expected future cash flows, as well as the risks to which those cash flows are exposed. An intention by one or both parties to settle on a net basis without the legal right to do so is not sufficient to justify offsetting because the rights and obligations associated with the individual financial asset and financial liability remain unaltered.”

“AG38A A right of set-off may be currently available or it may be contingent on a future event (for example, the right may be triggered or exercisable only on the occurrence of some future event, such as the default, insolvency or bankruptcy of one of the counterparties). Even if the right of set-off is not contingent on a future event, it may only be legally enforceable in the normal course of business, or in the event of default, or in the event of insolvency or bankruptcy, of one or all of the counterparties.

AG38B To meet the criterion in paragraph 42(a), an entity must currently have a legally enforceable right of set-off. This means that the right of set-off:

- (a) must not be contingent on a future event; and
- (b) must be legally enforceable in all of the following circumstances:
 - (i) the normal course of business;

- (ii) the event of default; and
- (iii) the event of insolvency or bankruptcy of the entity and all of the counterparties.”

“AG38D The laws applicable to the relationships between the parties (for example, contractual provisions, the laws governing the contract, or the default, insolvency or bankruptcy laws applicable to the parties) need to be considered to ascertain whether the right of set-off is enforceable in the normal course of business, in an event of default, and in the event of insolvency or bankruptcy, of the entity and all of the counterparties (as specified in paragraph AG38B (b)).”

Basis for Conclusions to International Accounting Standard (IAS) 32

“BC80 The Board believes that the net amounts of financial assets and financial liabilities presented in the statement of financial position should represent an entity’s exposure in the normal course of business and its exposure if one of the parties will not or cannot perform under the terms of the contract. The Board therefore clarified in paragraph AG38B that to meet the criterion in paragraph 42(a) of IAS 32 a right of set-off is required to be legally enforceable in the normal course of business, the event of default and the event of insolvency or bankruptcy of the entity and all of the counterparties. The right must exist for all counterparties so that if an event occurs for one of the counterparties, including the entity, the other counterparty or parties will be able to enforce the right of set-off against the party that has defaulted or gone insolvent or bankrupt.”

The Committee notes from the above-reproduced paragraphs that an entity can offset a financial asset and financial liability in the balance sheet when it currently has a legally enforceable right to set off and it intends to either set off on net basis or to realise the asset and settle the liability simultaneously. Further, an intention by one or both parties to settle on a net basis without the legal right to do so is not sufficient to justify offsetting because the rights and obligations associated with the individual financial asset and financial liability remain unaltered. The Committee notes that in the extant case, although the Company (as debtor) may intend to settle its financial liability against the financial asset (funds lying in the separate bank account), there is no right with the other parties, S-1 LLC (to whom the money is owed) to demand such set-off or with the Bank (with whom the bank balance is maintained) to do so or allow set-off on its own. As noted above, since special account was opened on the Company’s request and the Company can shift/transfer funds from such bank account to term deposits etc. to earn interest on the funds accumulated, it appears that the Company has the present ability to direct the use of the funds and thus, there is no legal right of set-off with the bank/S-1 LLC. Therefore, in the extant case, such a set-off of financial asset and financial liability cannot be made.

With regard to the contention of the querist regarding substance of the transaction for offsetting, the Committee notes the requirements of the Conceptual Framework, as reproduced below:

“Faithful representation

- 2.12 Financial reports represent economic phenomena in words and numbers. To be useful, financial information must not only represent relevant phenomena, but it

must also faithfully represent the substance of the phenomena that it purports to represent. In many circumstances, the substance of an economic phenomenon and its legal form are the same. If they are not the same, providing information only about the legal form would not faithfully represent the economic phenomenon (see paragraphs 4.59– 4.62).”

“Substance of contractual rights and contractual obligations

- 4.59 The terms of a contract create rights and obligations for an entity that is a party to that contract. To represent those rights and obligations faithfully, financial statements report their substance (see paragraph 2.12). In some cases, the substance of the rights and obligations is clear from the legal form of the contract. In other cases, the terms of the contract or a group or series of contracts require analysis to identify the substance of the rights and obligations.”

From the above, the Committee notes that the substance of the rights and obligations is determined in the context of the terms of the contract, as discussed above, and not in a generic sense.

40. With regard to presentation of financial asset (funds/bank balance in special purpose account) in the extant case, the Committee is of the view that the Company should inter alia consider whether the same meets the definition of ‘cash and cash equivalents’ as per the definition of Ind AS 7, ‘Statement of Cash Flows’ and accordingly, if it meets the definition of ‘cash and cash equivalents’, the Company should follow the requirements of Ind AS 1, Ind AS 7, and Schedule III to the Companies Act in this regard. The Committee also notes that as per paragraph 8.1.16 of the Guidance Note on Division II - Ind AS Schedule III to the Companies Act 2013, “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”. Thus, similar considerations should apply for presentation of funds for the purpose of Ind AS 1 and Ind AS 7. In this regard, the Committee also notes that Schedule III and paragraph 8.1.16 of the Guidance Note also state that “Earmarked balances with banks (for e.g., for unpaid dividend) shall be separately stated” and therefore, since in the extant case, the bank balance in the special purpose account has been earmarked for a specified purpose, the same should be presented separately and disclosed appropriately in the financial statements. Appropriate disclosure can also be given for the restriction or specific purpose for the use of these funds.

Similarly, with regard to presentation of financial liability, the Company should follow the requirements of Ind AS 1, Ind AS 107, Ind AS 109 and Schedule III to the Companies Act in this regard. Further, with regard to presentation of individual transactions or items on the face of the balance sheet, the Committee notes the following requirements of Ind AS 1, ‘Presentation of Financial Statements’:

“Material:

Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.

Materiality depends on the nature or magnitude of information, or both. An entity assesses whether information, either individually or in combination with other information, is material in the context of its financial statements taken as a whole.

...”

“Materiality and aggregation

- 29 An entity shall present separately each material class of similar items. An entity shall present separately items of a dissimilar nature or function unless they are immaterial except when required by law.**
- 30 Financial statements result from processing large numbers of transactions or other events that are aggregated into classes according to their nature or function. The final stage in the process of aggregation and classification is the presentation of condensed and classified data, which form line items in the financial statements. If a line item is not individually material, it is aggregated with other items either in those statements or in the notes. An item that is not sufficiently material to warrant separate presentation in those statements may warrant separate presentation in the notes.
- 30A When applying this and other Ind ASs an entity shall decide, taking into consideration all relevant facts and circumstances, how it aggregates information in the financial statements, which include the notes. An entity shall not reduce the understandability of its financial statements by obscuring material information with immaterial information or by aggregating material items that have different natures or functions.
- 31 Some Ind ASs specify information that is required to be included in the financial statements, which include the notes. An entity need not provide a specific disclosure required by an Ind AS if the information resulting from that disclosure is not material except when required by law. This is the case even if the Ind AS contains a list of specific requirements or describes them as minimum requirements. An entity shall also consider whether to provide additional disclosures when compliance with the specific requirements in Ind AS is insufficient to enable users of financial statements to understand the impact of particular transactions, other events and conditions on the entity’s financial position and financial performance.”

From the above, the Committee notes that material items need to be presented as separate line items in financial statements (which include the notes). As per Ind AS 1, materiality depends on the magnitude and/or nature of information. If a line item is not individually material, it is aggregated with other items either in those statements or in the notes. While applying Ind ASs, an entity shall decide, taking into consideration all relevant facts and circumstances, how it aggregates information in the financial statements. An entity need not provide a specific disclosure required by an Ind AS if the information resulting from that disclosure is not material except when required by law. Thus, the Committee is of the view that presentation of an item on the face of financial statements depends on the materiality of the specific item (including its nature) and the presentation/classification requirements as per Schedule III to the Companies Act and the requirements of Ind AS 1.

41. With regard to measurement of liability for transferring the abandonment fund to S-1 LLC including TDS, the Committee notes that the TDS deducted on interest accrued on the bank balance is the liability towards the Income-tax Department and not the liability towards the S-1 LLC and therefore, the same should be separately presented in the financial statements.

Further, since as discussed above, the bank balance is an asset of the Company, the interest earned on the same is an income of the Company and tax expense/liability on such income is also an expense/obligation of the Company. Therefore, till the funds are transferred to S-1 LLC, the funds along with any income including tax expense/liability (TDS) belong to the Company and should be appropriately recognised and presented in the financial statements of the Company.

D. Opinion

42. On the basis of the above and subject to the statements/limitations in paragraph 37 above, the Committee is of the following opinion on the issues raised in paragraph 36 above:

- (i) Set-off of the financial asset in terms of bank balance in special purpose account against the financial liability created for the contractual obligation to transfer/deliver such funds/cash for allotment of shares cannot be made, as discussed in paragraph 39 above.
- (ii)&(iii) With regard to presentation of financial asset (funds/bank balance in special purpose account), the Company should follow the requirements of Ind AS 1 and Schedule III to the Companies Act. Similarly, with regard to presentation of financial liability, the Company should follow the requirements of Ind AS 1, Ind AS 107, Ind AS 109 and Schedule III to the Companies Act. Further, with regard to presentation of individual transactions or items on the face of the balance sheet, the same depends on the materiality of the specific item (including its nature) and the presentation/classification requirements as per Schedule III to the Companies Act and the requirements of Ind AS 1, as discussed in paragraph 40 above.
- (iv) Till the funds are transferred to S-1 LLC, the funds along with any income including tax expense/liability (TDS) belong to the Company and should be appropriately recognised and presented in the financial statements of the Company, as discussed in paragraph 41 above.
