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Evaluating not-for-profit entities for consolidation under Ind AS 110 : Focus beyond financial returns



Many Indian companies have set-up not-for-profit entities (NPEs) to carry out corporate social responsibility (CSR) activities in compliance with the requirements of Section 135 of the Companies Act, 2013 (as amended) ('the Act') or other welfare measures for the society in the area where the Company is operating. These NPEs are generally structured as a charitable trust under the Indian Trusts Act, 1882, section 8 company incorporate under the Act, or a society registered under the Societies Registration Act, 1860. The Company or the Sponsoring Entity (SE) (hereinafter referred to as 'the Company') also makes initial contribution as well as ongoing contribution to the NPE to carry out CSR/ welfare activities. In many cases, the Company continues to be the sole contributor to the NPE activities; in other cases, the NPE may also be receiving contributions from other entities.

Salient features of NPEs

Given below are salient features of NPE which may be relevant for evaluating control under Ind AS 110 *Consolidated Financial Statements*:

1 | Purpose and funding

- The primary purpose of establishing an NPE is to fulfill the Company's CSR obligations and/ or to carry out other activities for meeting its welfare objective.
- The Company generally contributes funds and provides liquidity support to the NPE, for carrying CSR and/ or welfare activities.

2 | Initial set-up and ownership

- The Company sets up and makes initial contribution to the NPE. It is also the single/ largest shareholder in case of section 8 company. Similarly, the Company will be settlor of the Trust in case of a Charitable Trust.
- The Company is actively involved in deciding design and purpose of the NPE as well as finalizing its governing documents, such as Memorandum of Association (MOA) and Articles of Association (AOA) of section 8 company or Trust Deed of Charitable Trust.
- The CSR Rules under the Act mandate that CSR activities be undertaken either by the Company itself or through a Section 8 company established by the Company. In the case of CSR compliance, this is one key consideration in deciding structure of the NPE.

3 | Governance and decision making

- The Company, being sole shareholder or the settlor, has an exclusive right to appoint and remove all or majority board members or trustees of the NPE. Generally, these board members or trustees are key managerial personnel (KMPs) or other senior employees of the Company.
- Key activities of NPE generally include investment of surplus funds, borrowing (if required), and carrying out CSR/ welfare activities as per the governing documents. The decisions related to CSR/ Welfare activities may comprise identifying projects, identifying area to carry out these projects, deciding amount and involving service providers, etc. All these decisions are made by the board of directors/ trustees of the NPE.
- In certain cases, it is stated that the trustees/ board of directors have independent decision making. However, it may be noted that these trustees/ directors have fiduciary responsibility and need to carry out activities as per the framework laid in the governing documents, settlor/ shareholder as well as contributor to the fund.

4 | Restrictions on profit distribution

- As per the regulatory and/ or registration framework, NPE is explicitly prohibited from distributing any profits to its members/ shareholders. Nor it can repay capital/ initial contribution to the shareholders/ settlor.
- Any profits or income generated must be applied solely toward promoting its stated objectives. No portion of profits or property may be distributed, directly or

indirectly, as dividends, bonuses, or any other form to its members or shareholders.

- However, the above clauses do not restrict NPE from making below payments even if such payments accrue to the members or shareholders:
 - Out-of-pocket expense reimbursements
 - Prudent remuneration for services rendered
 - Reasonable interest on loans provided to the NPE
 - Reasonable rent for premises leased to the NPE
- In the event of liquidation, residual assets of the NPE will be transferred to another NPE carrying out similar activities.

Matter under evaluation

Considering the above structure, an issue has often been asked whether the Company needs to treat NPE as its subsidiary and therefore, should it consolidate the NPE under Ind AS 110?

Based on our understanding, this question arises primarily from the fact that the NPE is not allowed to repatriate profit or capital back to the Company. We also understand that there may be certain arguments that the Company does not get any financial return from its involvement with the NPE. Hence, the Company does not meet variable return criterion of control definition under Ind AS 110 and the Company need not consolidate the NPE.

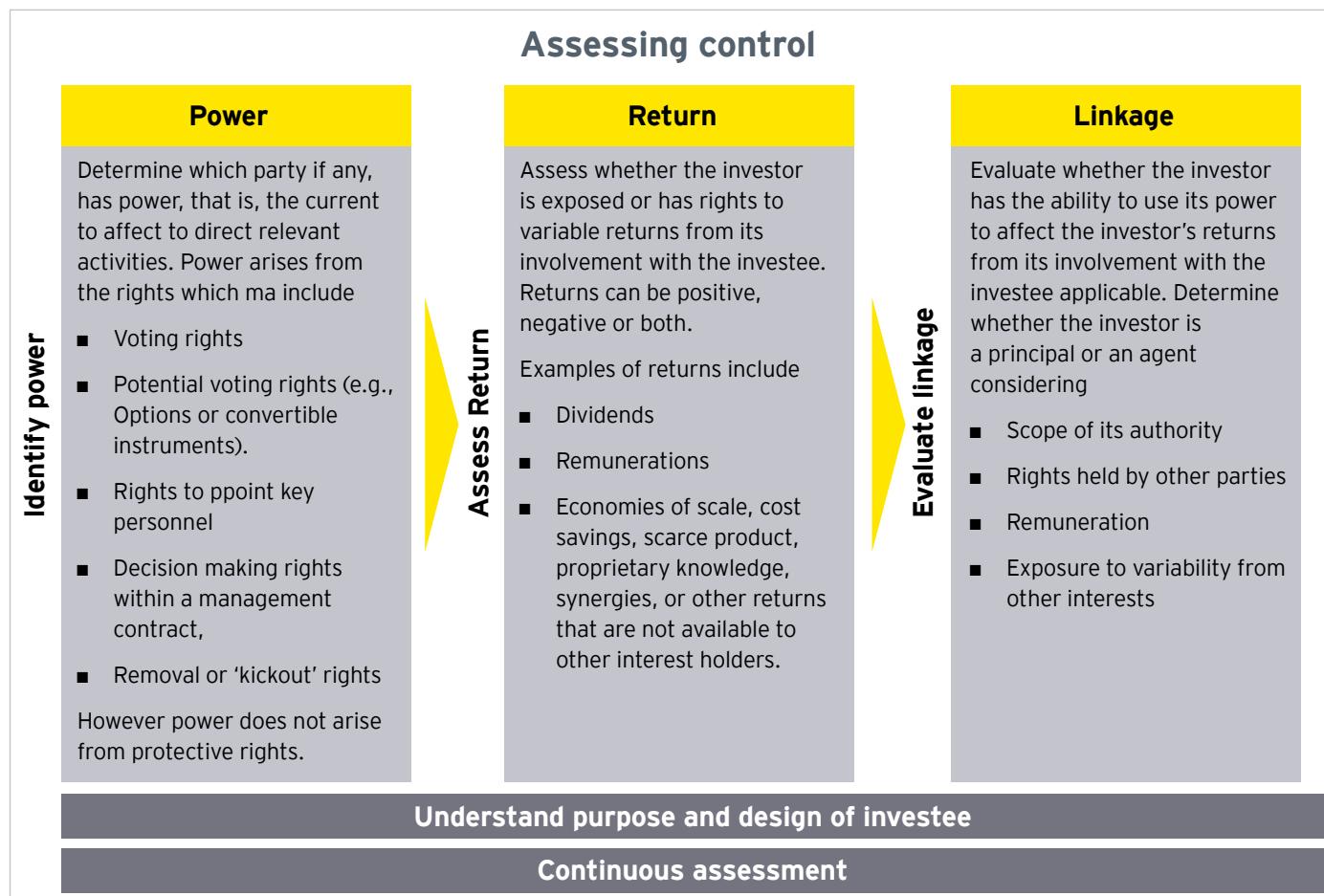
It is to be noted that the Expert Advisory Committee (EAC) of the Institute of Chartered Accountants of India (ICAI) had recently considered an issue related to NPE consolidation and it did not agree with the above view that there is no need to consolidate NPE since there is no variable return. In other words, the EAC concluded that, based on facts given, the NPE should be consolidated.

In this article, we analyze NPE consolidation matter under Ind AS 110 and our understanding of the position taken by the EAC. Whilst this article covers various aspects of control evaluation, it may be noted that the major debate on control evaluation relates to 'variable return' criterion and, therefore, the article focuses primarily on an evaluation of the said criterion.

Control evaluation of NPE as per Ind AS 110

Ind AS 110 *Consolidated Financial Statements* provides scope exclusion with regard to post-employment benefit plans or other long-term employee benefit plans to which Ind AS 19, *Employee Benefits*, applies. Hence, an entity or trust set-up to manage such plans is not considered for control evaluation under Ind AS 110. However, there is no such scope exclusion for NPEs. Hence, companies setting up NPEs or otherwise involved in their activities will need to evaluate them for consolidation under Ind AS 110.

Ind AS 110 establishes a single consolidation model based on the concept of control. Under Ind AS 110, an investor controls an investee and consequently consolidates it when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Given below is an overview of control model under Ind AS 110:



Ind AS 110 does not provide any scope exclusion for NPEs. Hence, control of NPE needs to be evaluated under the consolidation model prescribed in Ind AS 110.



For evaluating control over NPEs, application of the above criteria, particularly criteria related to variable return, can be challenging due to the unique structure of NPEs. Key aspects of control evaluation with specific focus on challenging part are described below.

1 | Understand purpose and design

When assessing control of the NPE, the Company considers purpose and design of the NPE in order to identify its relevant activities, how decisions about the relevant activities are made, who has the current ability to direct those activities and who receives returns from those activities. Understanding the purpose and design of an investee is therefore critical when identifying who has control. Understanding the purpose and design of the investee helps to determine:

- To what risks was the NPE designed to be exposed, and what are the risks it was designed to pass on to the parties with which it is involved?
- What are the relevant activities?
- How are decisions about the relevant activities made?
- Who has the ability to direct the relevant activities?
- Which parties have exposure to variable returns from the investee?
- How do the relevant activities affect returns?
- Do the parties that have power and have exposure to variable returns have the ability to use that power to affect returns?

In essence, grasping the NPE's purpose and design reveals the goals of each investor and parties involved, i.e., why they are involved with the investee and what that involvement is.

In the instant case, the primary purpose of establishing NPE is to fulfill the Company's CSR obligations and/ or to carry out other activities for meeting its welfare objective. The Company sets up and makes initial contribution to the NPE.



It is also the single/ largest shareholder in the case of section 8 company and settlor in case of the Charitable Trust. The Company is actively involved in deciding design and purpose of the NPE as well as finalizing its governing documents. These facts may indicate/ suggest a close relation between the Company's objective and the NPE activities, including how the NPE plays an important role in achieving the Company objectives.

2 | Power

The first criterion to have control relates to power. The power arises from existing rights that give the holder the current ability to direct the relevant activities. Relevant activities are the activities of the investee that significantly affect its returns. The rights that may give an investor power can differ between investees. Examples of rights that, either individually or in combination, can give an investor power include but are not limited to:

- a) Rights in the form of voting rights (or potential voting rights) of the investee
- b) Rights to appoint, reassign or remove members of an investee's key management personnel who have the ability to direct the relevant activities
- c) Rights to appoint or remove another entity that directs the relevant activities
- d) Rights to direct the investee to enter into, or veto any changes to, transactions for the benefit of the investor
- e) Other rights (such as decision-making rights specified in a management contract) that give the holder the ability to direct the relevant activities

Hence, Ind AS 110 gives an inclusive list of rights which either on their own or with other rights can suggest that the Company has power over the NPE. To evaluate this aspect, key questions to be asked are include:

- What are the relevant activities of the NPE?
- How decisions about these activities are made? Who makes those decisions?
- Who has the right to appoint and remove persons responsible for making those decisions?
- Whether the persons responsible for making decision playing role in fiduciary capacity? To whom they have such a fiduciary capacity?
- What are the rights the Company has with regard to relevant activities of the NPE?
- Does the Company directly or indirectly have the ability to direct relevant activities of the NPE?

- Can the Company directly or indirectly decide or influence key elements of the NPE decisions related to CSR/ welfare activities?
- Does the governance framework of the NPE provide the Company with the power over the subsidiary?

Based on our experience, in majority cases, it is clear that the Company has power over the relevant activities including investment of surplus funds, borrowing (if required), and carrying out CSR/ welfare activities as per the governing documents of the NPE. Such power may be arising from factors such as involvement in initial set-up, shareholding, right to appoint/ remove the board or trustees, and/ or directions issued at the time of contribution, etc. If the control is not clear, further evaluation may be needed.

3 | Variable returns

As stated above, variable return is one key factor/ challenge with regard to control evaluation over the NPE under Ind AS 110. In the regard, the following key requirements of Ind AS 110 may be noted:

B55. When assessing whether an investor has control of an investee, the investor determines whether it is exposed, or has rights, to variable returns from its involvement with the investee.

B56. Variable returns are returns that are not fixed and have the potential to vary as a result of the performance of an investee. **Variable returns can be only positive, only negative, or both positive and negative (see paragraph 15).** An investor assesses whether returns from an investee are variable and how variable those returns are on the basis of the substance of the arrangement and regardless of the legal form of the returns. For example, an investor can hold a bond with fixed interest payments. The fixed interest payments are variable returns for the purpose of this Ind AS because they are subject to default risk and they expose the investor to the credit risk of the issuer of the bond. The amount of variability (i.e., how variable those returns are) depends on the credit risk of the bond. Similarly, fixed performance fees for managing an investee's assets are variable returns because they expose the investor to the performance risk of the investee. The amount of variability depends on the investee's ability to generate sufficient income to pay the fee.

B57. Examples of returns include:

- Dividends, other distributions of economic benefits from an investee (e.g., interest from debt securities issued by the investee) and changes in the value of the investor's investment in that investee.

- Remuneration for servicing an investee's assets or liabilities, fees and exposure to loss from providing credit or liquidity support, residual interests in the investee's assets and liabilities on liquidation of that investee, tax benefits, and access to future liquidity that an investor has from its involvement with an investee.
- Returns that are not available to other interest holders. For example, an investor might use its assets in combination with the assets of the investee, such as combining operating functions to achieve economies of scale, cost savings, sourcing scarce products, gaining access to proprietary knowledge or limiting some operations or assets, to enhance the value of the investor's other assets."

Attention is also invited to the below basis for conclusion paragraphs to IFRS 10 (on which Ind AS 110 is based):

"BC39. The Board believes that reputational risk is part of an investor's exposure to risks and rewards, albeit a risk that arises from non-contractual sources. For that reason, the Board concluded that when assessing control, reputational risk is a factor to consider along with other facts and circumstances. It is not an indicator of power in its own right but may increase an investor's incentive to secure rights that give the investor power over an investee."

"BC62.... ED 10 used the term 'returns' rather than 'benefits' because 'benefits' are often interpreted as implying only positive returns.

BC63. The Board confirmed its intention to have a broad definition of 'returns' that would include synergistic returns as well as more direct returns, for example, dividends or changes in the value of an investment. In practice, an investor can benefit from controlling an investee in a variety of ways. The Board concluded that to narrow the definition of returns would artificially restrict those ways of benefiting.

BC64. Although some respondents to ED 10 commented that 'returns' could be interpreted narrowly to refer only to financial returns such as dividends, the Board believed that the broad description of returns included in the IFRS should ensure that the Board's intention to have a broad definition is clear. The Board also confirmed that an investor's returns could have the potential to be wholly positive, wholly negative or both positive and negative."

Considering the above, it may be noted that variable return under Ind AS 110 is a wide notion that also encompasses non-financial returns, such as, exposure to loss or expenses from providing funds, donation, credit or liquidity support and intangible benefits of reputation and image from good governance practices, synergistic returns that are not available to other interest holders, such as, combining operating functions to achieve economies of scale, impact on market capitalization, etc. Further, returns include not only positive returns, but negative returns as well.

Considering the above and specific facts outlined, one may make key arguments to states that the Company has exposure to variable returns arising from relevant activities of the NPE:

- The Company contributes funds for CSR/ welfare purposes and provides credit or liquidity support to the NPE, whose primary objective is to implement the CSR/ welfare activities. Thus, the NPE is apparently dependent on and carries out or manages CSR/ welfare activities on behalf of the Company. The Company involvement in these activities, along with the support it provides, further underscores its exposure to variable returns arising from the NPE activities.
- The Company has an exposure to variable returns in the form of exposure to statutory penalties for non-compliance with the Company's CSR obligations, loss from funding or providing liquidity support for running the NPE. In addition, there are likely to be intangible/ non-financial returns by way of enhancement or damage to reputation and image.

- Paragraph B57(c) of Ind AS 110 states that an investor might use its assets, with the investee's assets, to enhance the value of its other assets. From the Company's perspective, this could include the intangible benefit of being associated with the NPE and providing it with a support function.

Therefore, it can be argued that the NPE engaged in CRS/ welfare activities of the Company has the ability to affect the Company's returns.

How we see it

Variable return under Ind AS 110 is a wide notion which includes financial returns, such as exposure to loss or expenses from providing funds, intangible benefits of reputation and image from good governance practices. Further, under Ind AS 110, returns do not have to be generated within the investee. Rather, an investor could be exposed to the returns indirectly from its involvement with an investee.

4 | Linkage between power and returns

Through power, the Company can affect how the NPE's activities, are conducted and the resultant variable returns. Hence, this criterion for control evaluation will also be met.

Considering the above evaluation, it appears that the Company may have control over the NPE and need to consolidate financial statements of the NPE with its financial statements.



Practical challenge and perspective

As stated above, it is expected that based on Ind AS 110 evaluation, many companies may need to consolidate NPEs incorporated/ set-up by them or other NPEs where they are actively involved in operations and providing funding support. In such cases, practical challenges will arise as to how should the Company deal with the NPE's profits and/ or equity while preparing consolidated financial statements (CFS). Should such amounts be added to the profits and equity at the CFS level? If yes, will those amounts be reflected as non-controlling interest (NCI)?

Ind AS does not directly deal with these issues. In our view, in the absence of specific guidance, one may need to evaluate based on the requirements of other Ind AS and overall GAAP framework. It may be noted that under Ind AS 110, a combination of like items of assets, liabilities, equity, income, expenses, and cash flows of the parent with those of its subsidiaries is one of many consolidation procedures. Overall, the Standard requires consolidated financial statements to be prepared as the financial statements of a single economic entity. Hence, there is a need to apply all Ind AS again at the CFS level. In applying these Ind AS at the CFS level, the Company will need to evaluate whether the group has a legal, contractual or constructive obligation to spend the amount represented by the equity and/ or profit of the NPE toward specified activities? If any such obligation exists, the group may need to provide for those obligations as per the requirements of applicable Ind AS, e.g., Ind AS 37 *Provisions, Contingent Liabilities and Contingents Assets*. Similarly, as per the requirements of Ind AS 7 *Statement of Cash Flows*, the group may need to evaluate whether cash and bank balances of the group can be presented as cash and cash equivalents of the group or they are in the nature of restricted/ other bank balances?

We believe that the above evaluation may require exercise of significant judgment and also, in the absence of specific guidance, it is possible that different entities adopt different views. We recommend that the Ministry of Corporate Affairs (MCA), the National Financial Reporting Authority (NFRA) or the Institute of Chartered Accountants of India (ICAI) should provide an appropriate clarification or guidance on how to deal with this situation. Till the time such guidance is provided, it is imperative that the companies consider substance of their transaction in evaluating various possible views. They should also discuss and agree view with their auditors upfront.

How we see it

The Companies are likely to face unique challenges in consolidation of NPEs. To ensure consistency in handling such situations, we suggest that regulators and/ or standard setters should provide an appropriate guidance.

Conclusion

With the release of the Opinion by the EAC of the ICAI, it has become further clear that the Companies need to consider NPEs or similar entities for consolidation under Ind AS. The fact that the Company does not get dividend or similar other financial return will no longer be a valid argument to justify non-consolidation. Companies that may not have considered consolidation in the past should re-evaluate their position and agree on the way forward with their auditors upfront. They should also assess and address any other implications of consolidation in advance.

02

Revisiting segment disclosures: Key takeaways from IFRIC's clarification



IFRS 8 *Operating Segments* (and its equivalent under Ind AS, viz., Ind AS 108 *Operating Segments*) requires an entity to disclose specific information about assets, liabilities and profit or loss by segment. Ind AS 108 paragraph 23 requires an entity to disclose certain specified items of profit or loss for each segment. It also requires disclosure of material items of income and expense for each segment. The standard requires such disclosure if (a) these are included in the measure of segment profit or loss reviewed by the chief operating decision maker (CODM), or (b) are otherwise regularly provided to the CODM, even if not included in the measure of segment profit or loss.

Paragraph 23 of IFRS 8 requires the following disclosures:

"An entity shall report a measure of profit or loss for each reportable segment. An entity shall report a measure of total assets and liabilities for each reportable segment if such amounts are regularly provided to the chief operating decision maker. An entity shall also disclose the following about each reportable segment if the specified amounts are included in the measure of segment profit or loss reviewed by the chief operating decision maker, or are otherwise regularly provided to the chief operating decision maker, even if not included in that measure of segment profit or loss:

- a) Revenues from external customers
- b) Revenues from transactions with other operating segments of the same entity
- c) Interest revenue
- d) Interest expense
- e) Depreciation and amortization
- f) Material items of income and expense disclosed in accordance with paragraph 97 of IAS 1 *Presentation of Financial Statements*
- g) The entity's interest in the profit or loss of associates and joint ventures accounted for by the equity method

- h) Income tax expense or income and
- i) Material non-cash items other than depreciation and amortization

An entity shall report interest revenue separately from interest expense for each reportable segment unless a majority of the segment's revenues are from interest and the chief operating decision maker relies primarily on net interest revenue to assess the performance of the segment and make decisions about resources to be allocated to the segment. In that situation, an entity may report that segment's interest revenue net of its interest expense and disclose that it has done so."

In July 2024, the IFRS Interpretations Committee (IFRIC) agenda decision clarified on two key issues relating to segment disclosures required under the above paragraph of IFRS 8. Two key questions were posed to the IFRIC in this regard:

- (i) Whether an entity is required to disclose items as stated in paragraph 23 that are not separately reviewed by the CODM but that are included in the CODM's measure of segment profit?
- (ii) How should an entity decide material items requiring to be disclosed under paragraph 23(f) of IFRS 8, which in turn refers to paragraph 97 of IAS 1?

With regard to the first issue, the IFRIC reiterated/ clarified that paragraph 23 of IFRS 8 requires an entity to report a measure of profit or loss for each reportable segment and to disclose specified amounts for each reportable segment. Paragraph 23 requires an entity to disclose the specified amounts for each reportable segment when those amounts are:

- Included in the measure of segment profit or loss reviewed by the CODM, even if they are not separately provided to or reviewed by the CODM or
- Regularly provided to the CODM, even if they are not included in the measure of segment profit or loss

Consider following examples:

- An entity has three reportable segments, and it reports profit before tax as segment result for each segment of the CODM. In this case, segment wise depreciation/ amortization, interest expense and interest revenue are included in the measure of segment profit or loss reviewed by the CODM. Hence, the entity should disclose break-up of segment wise depreciation/ amortization, interest expense and interest revenue in the segment information. This is despite the fact that segment wise depreciation/ amortization, interest expense and interest revenue is not otherwise reviewed by the CODM.

- An entity has three reportable segments, and it reports Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA) as segment result for each segment of the CODM. In this case, segment wise depreciation/ amortization, interest expense and interest revenue are not included in the measure of segment profit or loss reviewed by the CODM. However, the entity otherwise provides segment wise depreciation/ amortization, interest expense and interest revenue to the CODM, and these measures are otherwise reviewed by the CODM. In this case also, the entity should disclose break-up of segment wise depreciation/ amortization, interest expense and interest revenue, in the segment information.

With regard to the second issue, the IFRIC clarified that to identify material items of income and expense requiring disclosure in accordance paragraph 23(f) of IFRS 8, read with paragraph 97 of IAS 1, an entity:

- Applies paragraph 7 of IAS 1 and assesses whether information about an item of income and expense is material in the context of its financial statements taken as a whole
- Applies the requirements in paragraphs 30-31 of IAS 1 in considering how to aggregate information in its financial statements
- Considers the nature or magnitude of information—in other words, qualitative or quantitative factors—or both, in assessing whether information about an item of income and expense is material, and
- Considers circumstances including, but not limited to, those in paragraph 98 of IAS 1

The Committee further observed that paragraph 23(f) of IFRS 8 does not require an entity to disclose by a reportable segment each item of income and expense presented in its statement of profit or loss or disclosed in the notes. In determining information to disclose for each reportable segment, an entity applies judgement and considers the core principle of IFRS 8 - which requires an entity to disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates.



How we see it

We believe that IFRIC Agenda Decision will require entities to review presentation/ disclosure of segment information, particularly segment wise break-up of income and expense. In the past, some entities may have interpreted the requirement to disclose material income and expense items (if they were included within the measure of segment profit or loss) to only relate to exceptional or non-recurring items, such as material restructurings. It is obvious that such entities will need to revisit their segment information and may need to disclose segment wise break-up for more items of income or expense, if the specified amounts are included in the measure of segment profit or loss reviewed by the CODM, or are otherwise regularly provided to the CODM, even if not included in that measure of segment profit or loss.

The identification and determination of what is material to the financial statements (both quantitatively and qualitatively) has always been a highly judgemental area, and the segment note is no exception. Refer below scenarios on how entities may exercise such judgment.

Scenario 1: Segment disclosure for retail company

ABC Limited is a retail company having operations in various parts of the world. It discloses segment information by four geographical regions. It reports profit before tax as a segment result to the CODM. In arriving at profit before tax, the cost of goods sold is included as one major expense line item, and it is also the largest expense in the statement of profit and loss. Determination of profit before tax also includes depreciation/ amortization as well interest expense primarily for retail premises taken on lease. ABC did not have other expense items included in the profit before tax measure that were considered being material. In its financial statements for the year ended 31 March 2024, the cost of goods sold, depreciation/ amortization and interest expense were not reported by segment.

Issue

Should ABC report the cost of goods sold, depreciation/ amortization and interest expense by segment in its financial statements for the year ended 31 March 2025?

Response

Post IFRIC Agenda Decision, it appears likely that ABC will need to disclose cost of goods sold, depreciation/ amortization and interest expense by segment in the segment note for the year ended 31 March 2025 financial statements, for below reasons:

- As the single largest expense and key cost driver for ABC, providing the cost of goods sold information by segment would be expected to influence the decisions of financial statement users. Thus, this expense is material in the context of the financial statements as a whole.
- Paragraph 23 of IFRS 8 requires segment wise disclosure for depreciation/ amortization and interest expense.
- Segment wise cost of goods sold, depreciation/ amortization and interest expense are included in the measure of segment profit or loss reviewed by the CODM.

Scenario 2: A service company with significant employee costs

MNO Limited is a service company having operations in various parts of the world. It discloses segment information by four geographical regions. It reports EBITDA as segment result to the CODM. MNO has significant employee costs which are presented separately on the face of the statement of profit and loss. MNO did not have other expense items included in EBITDA that were considered to be material. The measurement of EBITDA does not include items such as depreciation/ amortization, interest expense and interest income. Nor segment wise break of these items is otherwise reviewed by the CODM. In its financial statements for the year ended 31 March 2024, MNO did not report segment wise employee costs.

Issue

Should MNO report disaggregated employee costs by segment in the segment note in its financial statements for the year ended 31 March 2025?

Response

We believe that IFRIC Agenda Decision will require MNO to disclose segment-wise break-up for employee costs in the segment note of its financial statements for the year ended 31 March 2025. This view can be supported by the below key reasons:

- Employee costs are material expense for MNO. It is expected that the information by segment will influence the decisions of the financial statement users.
- The magnitude of the item (both quantitatively and qualitatively) supports the conclusion that the employee cost expense line item is material in the context of the financial statements as a whole.

One may argue that components of the employee costs (for example, salaries, bonus, share-based payments and post-employment benefits) can be aggregated as the nature of expense is similar and this disaggregated information is not material from a segment reporting perspective.

Segment wise depreciation/ amortization, interest expense and interest income are neither included in the measure of segment profit or loss reviewed by the CODM nor these are otherwise provided to or reviewed by the CODM. Hence, there is no need to disclose segment wise break-up of depreciation/ amortization, interest expense and interest income.



Impact on comparatives

Agenda decisions issued by the IFRS Interpretations Committee form an important source of guidance. The IFRIC has decided not to amend the standard as it is believed that the position is already clear from the IFRS Accounting Standards. Thus, relevant agenda decisions should be carefully considered and compliance ensured when selecting a suitable accounting policy for a transaction.

Agenda decisions, in many cases, include explanatory material. Explanatory material may provide additional insights that might change an entity's understanding of the principles and requirements in IFRS Accounting Standards. Because of this, an entity might determine that it needs to change an accounting policy as a result of an agenda decision that has been published and when that change should be made. Changes in accounting policies as a result of agenda decisions are generally voluntary changes in accounting policies, unless an entity determines it relates to a correction of an error. Voluntary changes in accounting policies are applied retrospectively, except to the extent that it is impracticable. Impracticability is a very high threshold under IAS 8/ Ind AS 8 ***Accounting Policies, Changes in Accounting Estimates and Errors*** and we expect that it is only in limited circumstances that it will be impracticable to apply a voluntary change in accounting policy retrospectively.

Generally, changes applied in response to an agenda decision result in voluntary accounting policy change in accordance with Ind AS 8 and need to be applied retrospectively.

There is no fixed time limited to apply IFRIC Agenda Decisions and entities are generally expected to apply the same as soon as possible and within a reasonable time. Entities will need to apply judgement to determine what sufficient time is in this context. We expect that, in most cases, sufficient time would only be a matter of months, but it is highly unlikely that it could extend for more than a year. Entities should also consider the views of regulators.

When management has concluded that a change in an accounting policy is required as a result of an agenda decision but that change has not been made yet, they should consider providing disclosures similar to those provided about forthcoming standards in accordance with paragraphs 30 and 31 of Ind AS 8.

We believe that IFRIC Agenda Decision only clarifies the requirements which are already existing in IFRS Accounting Standards as well as Ind ASs. Hence, it will also apply under Ind AS.

Conclusion

The IFRIC agenda decision reinforces the need for greater transparency and consistency in segment reporting, which is vital for providing stakeholders with a clearer understanding of an entity's financial performance. The clarity provided by the Agenda Decision is expected to help entities eliminate ambiguity and ensure that material income and expense items are consistently disclosed.

03

Net zero commitment: Need to recognize provision?



The efforts to reduce the society's impact on climate change have never been greater. Climate change is impacting economy and businesses at large with an increased frequency and intensity all over the world, including India. Investors have highlighted the importance of reducing entities' impact on the environment in their investment-making decisions and their assessment of management's stewardship. In November 2021, through the Glasgow Financial Alliance for net zero, over US\$130 trillion of private capital has been committed to accelerating the transition to a zero-emissions economy by 2050.

Countries across the globe have declared their own targets for reducing carbon emissions as well as for achieving the target of net zero Emissions. India has also set a target to halve its carbon emissions by 2030 and achieve net zero status by 2070. In line with the targets at country level, corporate entities have also set targets of carbon emission reduction and becoming net zero for themselves. These entities are taking various steps to achieve these targets.

As climate-related matters continue to evolve and entities make further commitments and take additional actions to tackle climate change, it is important for them to ensure that their financial statements reflect the most up-to-date assessment of climate-related risks and their impact on the financial statements. Although, there is no single explicit standard on climate-related matters under IFRS Accounting Standards, climate risk and other climate-related matters may impact a number of areas of accounting. Some relevant examples include assessment/ reassessment of useful life, residual value, overhaul and decommissioning obligations of property, plant and equipment (PPE), impairment of assets, recognition of provisions and disclosure of contingent liabilities, fair value measurement of financial and non-financial assets, measurement of expected credit losses on financial assets, accounting for carbon/ renewable energy credits, appropriate presentation and disclosure in the financial statements. Depending on facts and circumstances of each entity, one or more of these areas may be particularly impacted. It is imperative that each entity evaluates and addresses such impact carefully.

In this Article, we address one critical area of accounting likely to be impacted by climate change. This Article deals with evaluation whether and when an entity needs to recognize provision for obligation arising from its net zero commitment.

Net zero commitment – What is the issue and related guidance?

Many entities have publicly pledged to reduce their carbon footprint and achieve other sustainability goals. As they enhance their sustainability disclosures in the annual report and via other means, there is now a growing focus on the connectivity between sustainability information and financial information. This, among other matters, requires companies to evaluate whether its commitment to reduce or offset greenhouse gas emissions creates a constructive obligation and whether there is a need to create a provision for the same under Ind AS 37 *Provisions, Contingent Liabilities and Contingent Assets*?

Whilst Ind AS 37 does not directly deal with accounting for obligation, if any, arising from net zero commitments, it prescribes below accounting, which may be relevant:

- a) Ind AS 37 requires a provision to be recognized when an entity has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the obligation. At the same time, Ind AS 37 does not allow an entity to recognize a provision for future operating losses.
- b) Except in the case of an onerous contract, the amount required to be recognized as a provision is the best estimate of the expenditure required to settle the present obligation at the end of the reporting period. In the case of an onerous contract, the amount required to be recognized as a provision is not based on an estimate of an expected outcome. Instead, the provision reflects the lower of the costs of fulfilling the contract and any compensation or penalties from a failure to fulfil it (regardless of what the entity expects to do).
- c) If any of the conditions for recognition are not met, no provision is recognized and an entity may instead have a contingent liability. Contingent liabilities are not recognized, but explanatory disclosures are required, unless the possibility of an outflow in settlement is remote.

- d) Ind AS 37 requires disclosures to enable users to understand the nature, timing and amount of provisions and contingent liabilities. For both provisions and contingent liabilities, this includes an indication of the uncertainties relating to the amount or timing of any outflow.

We believe that the application of the above principles to net zero commitments may require exercise of significant judgment.

Net zero commitment – recent developments

In November 2023, the IFRS Interpretations Committee (IFRIC) discussed a submission related to climate-related (net zero) commitments made by an entity. In the fact pattern submitted to the IFRIC, a manufacturer of household products publicly states its commitment to gradually reduce its annual greenhouse gas emissions by at least 60% of their current level by a specific year and to offset its remaining annual emissions in that year and subsequently, by buying carbon credits and retiring them from the carbon market. To support its statement, the Company publishes a transition plan setting out how it will gradually achieve the 60% reduction in its annual emissions by modifying and investing in more energy efficient manufacturing processes and sourcing alternative materials with a lower-carbon footprint. Management is confident that the Company can make all of these modifications and continue to trade profitably. In addition to publishing the transition plan, the Company takes several other actions that publicly affirm its intention to fulfil its commitments.

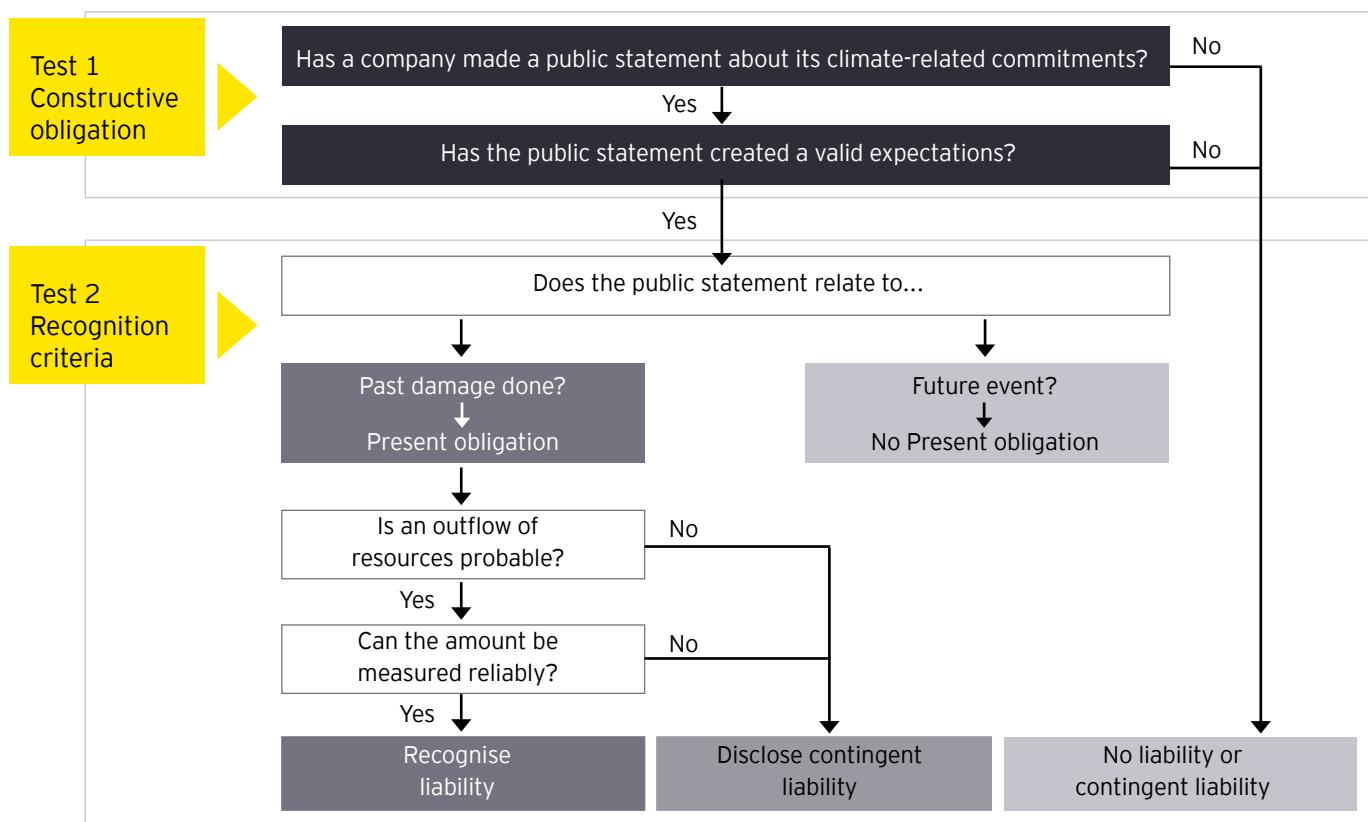


The IFRIC discussed the requirements of IAS 37 (corresponding to Ind AS 37) in detail. The IFRIC noted that to recognize a provision for net zero commitment, the following two tests need to be met:

- (i) The entity's commitment to reduce or offset its greenhouse gas emission creates a constructive obligation for the entity.
- (ii) Constructive obligation created by the commitment meets IAS 37 criteria for recognition of provision.

The IFRIC decided that an entity should recognize the liability when both the tests are met. The IFRIC concluded that the principles and requirements in IFRS Accounting Standards provide an adequate basis for an entity to deal with the matter. Consequently, the IFRIC decided not to add a standard-setting project to the work plan. The agenda decision was ratified by the IASB in April 2024.

Based on IFRIC Agenda Decision, given below is diagram which may help entities to evaluate whether a provision for net zero commitment needs to be recognized:



Does the entity have a constructive obligation?

An entity will have a constructive obligation if its public statement has created a valid expectation that the entity will fulfill its commitment to reduce or offset emissions. Determining whether the entity has created a valid expectation will depend on the facts of the commitment and the circumstances surrounding it. Therefore, management needs to apply judgement to reach a conclusion. If those facts or circumstances change over time, the conclusion could do so as well. There are several factors which an entity should consider in making this analysis. Given below is an inclusive list of factors which can be relevant:

- What language is used in the statement? If statements describe the actions an entity 'will take', 'is committed to taking' or 'pledges to take', they are more likely to indicate that an entity will fulfill the commitment than statements that describe the entity's 'ambitions', 'targets' or 'aspirations.'
- What is the specificity and status of plans supporting the statement? Statements are more likely to raise a valid expectation that the entity will achieve its greenhouse gas emission reductions target if they are supported by formally approved plans detailing, for example:

- The nature and timing of the actions an entity will take to achieve the reductions.
- Milestones an entity has committed to achieve on the path to the longer-term goals.
- How management will measure progress towards the milestones and longer-term goals (for example, the metrics an entity will use).
- What is the expected timing of the actions required to fulfill the commitment? Plans for short- and medium-term actions are less likely to be changed than those for longer-term actions.
- Is evidence of progress to date publicly available? Evidence that an entity has achieved milestones it committed to in previous statements may enhance expectations that it will achieve milestones and longer-term goals it currently declares to commit to in its statement. Conversely, evidence that an entity has failed to achieve previous milestones may reduce those expectations.

Management would apply judgement to reach a conclusion at each reporting date considering all relevant facts and circumstances existing at that date.

Present obligation as a result of a past event

Even if net zero commitment related statements indicate to the public that an entity has accepted responsibility for reducing or removing greenhouse gas emissions, it does not automatically mean that a provision can, or must, be recognized. Rather, the financial reporting consequences and the applicable requirements in IFRS Accounting Standards/ Ind AS will depend on the planned actions. For example, an entity that plans to replace certain assets with low-emitting ones will need to consider whether, or when, it has a capital commitment under Ind AS 16 *Property, Plant and Equipment*. Retiring existing assets could affect both impairment assessments and reassessments of useful life. In some cases, while called a 'commitment', the planned actions might be subject to change without penalty or contingent on future events; they might also be covered by other liabilities, such as decommissioning provisions. Therefore, understanding the specific planned actions underlying the entity's net zero commitment is crucial to the appropriate application of IFRS accounting standards/ Ind AS.

If the entity's actions are to be accounted for under Ind AS 37 (for example, if the entity determines it will need to pay penalty), it is important to determine the existence of a present obligation, which may trigger recognition of a provision. Ind AS 37 requires the existence of a present obligation in order to recognize any liability. A past event

can lead to a present obligation only if "the entity has no realistic alternative to settling the obligation created by the event". As under the general requirements of Ind AS 37, the enactment of a law is not sufficient to give an entity a present legal obligation, the publication of a policy or statement is not sufficient to give an entity a present constructive obligation – an entity has a present legal or constructive obligation only when the event to which the law, policy or statement applies has occurred. For example, as illustrated in Illustrative Example 2B accompanying IAS 37, an entity with a widely published policy of cleaning up land it contaminates incurs a present obligation only when it contaminates land – publishing the policy is necessary but not sufficient to give the entity a present obligation.

In the context of climate-related (net zero) commitments, it may be noted that:

- When the entity publishes a climate-related (net zero) commitment that requires future action (e.g., modifying its manufacturing methods, purchasing and retiring carbon credits in the future), the related costs need to be incurred to operate in the future. The obligations to incur those costs do not exist independently of the entity's future actions. Accordingly, there is no present obligation for those costs when the entity publishes its commitment.
- An entity will have a present obligation for the modifications to its manufacturing methods once it has to pay for resources it purchases to modify its methods – for example, to pay for new plant or equipment or for renewable energy – but only when it receives those resources. Similarly, in the case of commitment to offset greenhouse gas emissions, the entity will have a present obligation only when the entity emits the gases it has committed to offset.



Probable outflow of resources

The second criterion for recognizing a provision is that it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation. In the context of climate-related (net zero) commitments, it may be noted that:

- Settling the constructive obligation to reduce the entity's annual greenhouse gas emissions will not require an outflow of resources embodying economic benefits. As the company carries out its transition plan to reduce emissions, it will receive other resources (such as property, plant and equipment and inventories) in exchange, and will be able to use these resources to manufacture products it can sell at a profit.
- In case of commitment to offset greenhouse gas emissions, the entity will have a present obligation only when the entity emits the gases it has committed to offset. The entity will be required to buy and retire carbon credits without receiving any resources embodying economic benefits in exchange.

Sustainability developments in recent years have also highlighted emerging accounting issues including those related to net zero commitments. Based on the requirements of Ind AS 37, a commitment to reduce emissions is accounted for differently than a commitment to offset emissions. Management will need to monitor standard setting developments on these issues and follow related regulatory actions as sustainability set to remain a hot topic in the foreseeable future.

Reliable estimate

The final criterion for recognizing a provision is that a reliable estimate can be made of the amount of the obligation. Paragraph 25 of IAS 37/ Ind AS 37 states that 'except in extremely rare cases, an entity will be able to determine a range of possible outcomes and can therefore make an estimate of the obligation that is sufficiently reliable to use in recognizing a provision.'

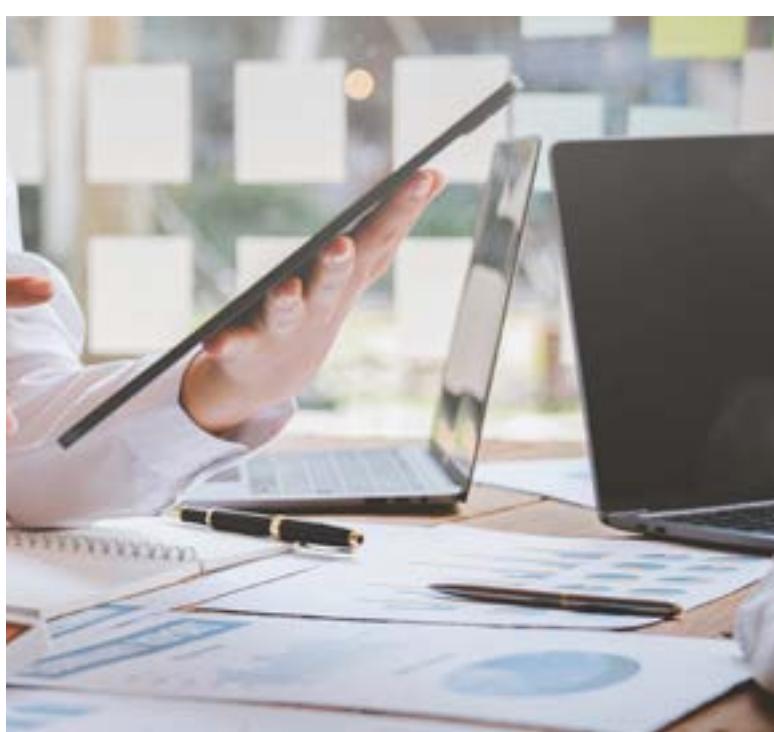
Hence, it is likely that the entity would be able to make a reliable estimate of the amount of a constructive obligation that satisfy the other recognition criteria.

Concluding remarks

The rising public emphasis by businesses on net zero goals increases the demand for integrated sustainability and financial information. The IFRS Interpretations Committee's decision on whether a company's statement of its commitment to cut or offset its future carbon emissions from their current level creates a constructive obligation for the company, and, if so, whether a provision needs to be recognized by the company will require judgement of facts and circumstances.

Since an entity's specific plans are key to appropriately accounting for such commitments, entities need to consider including appropriate explanatory disclosures to assist users of financial statements to understand the impact. Furthermore, entities should be careful to ensure that clear language is used in describing their aspirations, targets and intended actions in response to the climate change challenge. For example, a reader may have difficulty understanding the extent to which the entity can realistically withdraw from a course of action described in its transition plan.

Since an entity's specific plans are key to appropriately accounting for net zero commitments, entities need to consider including appropriate explanatory disclosures to assist users of financial statements to understand the impact.



04

Classification of liabilities as current or non-current is expected to change: Are you ready?



The International Accounting Standards Board (IASB) has issued two amendments to IAS 1 *Presentation of Financial Statements* (The Amendment), introducing important changes to the requirements for current vs. non-current classification of liabilities. Under IFRS Accounting Standards, these changes are applicable for annual periods beginning on or after 1 January 2024. Similar changes are expected to be made in Indian Accounting Standards (Ind AS) and will apply for financial years beginning on or after 1 April 2024.

For most entities engaged in manufacturing/ supply of goods or services, separate classification of current and non-current assets and liabilities in the balance sheet provides useful information by distinguishing the net assets that are continuously circulating as working capital from those used in the entity's long-term operations. It also highlights assets that are expected to be realized within the current operating cycle, and liabilities that are due for settlement within the same period. In practice, current vs. non-current classification of assets and liabilities also helps users of financial statements in better understanding/ evaluating short-term liquidity position of the entity. Also, there may be debt covenants and other key performance indicators (KPIs) linked to the current ratio. Hence, there is no doubt that current vs. non-current classification of assets and liabilities is one of the key focus areas for the preparers as well as users of the financial statements.

To clarify the existing requirements for classification of liabilities as current vs. non-current and to address certain issues arising in the practical application, the International Accounting Standards Board (IASB) issued two amendments to IAS 1 *Presentation of Financial Statements*, in January 2020 and October 2022. The amendments have been made only to the requirements for classification of liabilities as current or non-current and there are no changes to the criteria for requirements for classification of assets. Some of the changes in criteria are likely to have a major impact on classification of liabilities as current or non-current. Given below is the comparison of pre-amendment and post-amendment criteria:

Pre-amendment criteria	Post-amendment criteria
An entity shall classify a liability as current when: <ul style="list-style-type: none"> a) It expects to settle the liability in its normal operating cycle b) It holds the liability primarily for the purpose of trading c) The liability is due to be settled within 12 months after the reporting period or d) It does not have an unconditional right to defer settlement of the liability for at least 12 months after the reporting period. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification 	An entity shall classify a liability as current when: <ul style="list-style-type: none"> a) It expects to settle the liability in its normal operating cycle b) It holds the liability primarily for the purpose of trading c) The liability is due to be settled within 12 months after the reporting period or d) It does not have the right at the end of the reporting period to defer settlement of the liability for at least 12 months after the reporting period
An entity shall classify all other liabilities as non-current	An entity shall classify all other liabilities as non-current
When an entity presents current and non-current assets, and current and non-current liabilities, as separate classifications in its statement of financial position, it shall not classify deferred tax assets (liabilities) as current assets (liabilities)	When an entity presents current and non-current assets, and current and non-current liabilities, as separate classifications in its statement of financial position, it shall not classify deferred tax assets (liabilities) as current assets (liabilities)

The amendments have also added various clarifications and related requirement to supplement/ elaborate change in the criteria. Also, new disclosure requirements have been added in the amended IAS 1.



Overview of key amendments

The changes have been made to the criteria for classification of liabilities and there are no changes to the criteria applicable for current vs. non-current classification of assets.

- **Right to defer settlement:** It has been clarified that the liability arising from a loan agreement is classified as non-current if the entity has a right to defer its settlement for 12 months after the reporting date. It does not matter that the right to defer settlement is conditional on the entity complying with debt covenants after the reporting date.
- **Expected deferrals:** The classification of financial liabilities as current vs. non-current depends on when they are due for settlement and whether the entity has a right to defer its settlement for 12 months after the reporting date. For this purpose, the expectation or likelihood whether the entity will exercise its right to defer settlement is not relevant.
- **Settlement by way of own equity instruments:** Settlement by way of an entity's own equity instruments is considered settlement for the purpose of classification of liabilities as current or non-current, with one exception, if, and only if, the conversion option itself is classified as an equity instrument, would be disregarded.
- **Disclosures:** Additional disclosures have been prescribed for entities that classify liabilities arising from loan arrangements as non-current when the right to defer settlement of liabilities is subject to the entity complying with future covenants within 12 months.

Right to defer settlement

The pre-amended IAS 1 required that to classify a liability as non-current, an entity should have ***an unconditional right to defer its settlement*** for at least 12 months after the reporting date. It may be noted in practice, many bank loan and other financial liability agreements require borrower to comply with debt covenants either on an ongoing basis (e.g., there should be no change in control and there should be no material adverse event during the loan tenure) or more frequently than an annual basis (e.g., the borrower should ensure specified debt-equity ratio and current ratio on quarterly or half-yearly basis). Whilst the borrower may expect to comply with these requirements; however, they are not within borrower's control. Hence, there was an issue whether such loans/ financial liabilities meet IAS 1 criteria for classification as non-current liability. It appears that different entities have interpreted and applies this requirement in different manners, resulting in a diversity of practice, which makes it difficult for users to understand and compare financial statements.

Post amendment, the standard no longer refers to an 'unconditional right'; rather, it simply refers to the right to defer settlement. Hence, it seems clear that even a conditional right to defer settlement will result in non-current classification of loan agreement/borrowings. Further, a new paragraph has also been added which now clarifies that **the 'right'** to defer settlement of a liability for at least 12 months must have substance and needs to exist at the end of the reporting period in order to classify a liability as non-current. It has also been clarified that the right to defer settlement may be subject to the entity complying with the covenants specified in the loan agreement; only the covenants requiring compliance on or before the reporting date are relevant to decide the classification, even if compliance with those covenants is assessed after that date. However, covenants which need to be complied with only after the reporting date (i.e., future covenants) do not affect a liability's classification at the reporting date. Instead, the amendments require entities to disclose information about such covenants and related liabilities in the notes.

Only the covenants specified in loan agreement and requiring compliance **on or before** the reporting date affect classification of the liability. Any future covenant is ignored for classification purposes.



Expected deferrals/ expectations to settle early

The amendment clarifies that for a liability to be non-current, an entity must have a right to defer its settlement for at least 12 months after the reporting date and it does not matter whether the entity will exercise such right. The reference to the entity's expectations in paragraph has been deleted and a new paragraph has been added to bring this aspect more explicitly. The new paragraph states that classification of a liability is unaffected by the likelihood that the entity will exercise its right to defer settlement of the liability for at least 12 months after the reporting period. If a liability meets the criteria stated above for classification as non-current, it is classified as non-current even if management intends or expects the entity to settle the liability within 12 months after the reporting period, or even if the entity settles the liability between the end of the reporting period and the date the financial statements are authorized for issue. However, in either of those circumstances, the entity may need to disclose information about the timing of settlement to enable users of its financial statements to understand the impact of the liability on the entity's financial position.

How we see it

The IASB has clarified that classification of loans and similar financial liabilities is unaffected by the management expectations/ intention to settle within 12 months after the reporting date. By implication, it appears that the criterion 'the entity expects to settle the liability in its normal operating cycle' for current classification of liability is relevant only for liabilities, such as trade payables and some accruals for employee and other operating costs, which are part of the working capital used in the entity's normal operating cycle. The said criterion is not applicable for the classification of loans and other similar financial liabilities.

Impact of breaches to debt covenants

IAS 1 position

Under the IFRS Accounting Standards, there are no material changes to the requirements concerning breaches of debt covenants. On the lines of pre-amended IAS 1, the amended IAS 1 clarifies that when an entity breaches a covenant of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand, it classifies the liability as current, even if the lender agreed, after the reporting period and before the authorization of the financial statements for issue, not to demand payment as a consequence of the breach. An entity classifies the liability as current because, at the end of the reporting period, it does not have the right to defer its settlement for at least 12 months after that date.

However, an entity classifies the liability as non-current if the lender agreed by the end of the reporting period to provide a period of grace ending at least 12 months after the reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment.

Position under Ind AS 1 Presentation of Financial Statements

As compared to IAS 1, the current Ind AS 1 contains the following two carve outs on this matter:

- Under Ind AS 1, only a breach of material provision/ covenant of long-term loan will trigger current classification of the liability. If there is a breach of minor provision/ covenant, the entity can continue classifying the loan as non-current. In practice, differentiation between breach of material and minor covenants may require exercise of the judgment and such assessment/ determination may change from one entity to another and for the same entity over different periods.
- In accordance with Ind AS 1, if there is a breach of a material covenant of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand on the reporting date and the lender has agreed, after the reporting period and before the approval of the financial statements for issue, not to demand payment as a consequence of the breach, then the entity need not to classify the liability as current. In other words, under Ind AS, the waiver granted by the lender after the reporting date and before the approval of the financial statements for issue is treated as an adjusting event.

In the Exposure Draft of the proposed amendments to Ind AS 1 issued by the Accounting Standards Board (ASB) of the ICAI, it was proposed to remove both the above carve outs and align Ind AS with the requirements of IAS 1. It may, however, be noted that the final amendments in Ind AS 1 are yet to be notified. Hence, the final position that will prevail once Ind AS changes are notified is not known.

How we see it

The current version of Ind AS 1 contains two important carve outs which allow entities to classify liability as non-current in a scenario where they breach only non-material debt covenant in a loan agreement and/ or in scenario if they are able to get lender waiver after the reporting date. The ASB of the ICAI had proposed to remove both these carve-outs and align requirements with IAS 1. The final outcome will be known when amendments to Ind AS 1 are notified.



Practical examples

To explain requirements of the above amendments to IAS 1, given below are certain examples. In each of the scenarios, the entity has 31 March year-end, and it is evaluating current vs. non-current classification of liability in IFRS financial statements for the year ended 31 March 2025. Unless stated otherwise, the entity has taken INR1,000 crore loan from the bank, which is repayable on 31 March 2029.

Scenario 1	<ul style="list-style-type: none"> ■ The loan agreement requires compliance with debt covenants at the end of each quarter, i.e., 30 June, 30 September, 31 December and 31 March 2025. ■ The entity has complied with all covenants till 31 March 2025. ■ The entity expects to comply with covenants going forward also. However, it is not within the entity's control. 	<p>The entity has the right to defer the settlement for at least 12 months at the reporting date. The future covenants do not affect the classification of liability at the reporting date.</p> <p>As there has been no breach of debt covenant till 31 March 2025, the entity classifies the loan as non-current.</p> <p>Since future covenants do not impact classification, the same position would have applied if the entity has complied with all covenants till 31 March 2025 and it was uncertain about continuing compliance with debt covenants or it was expected that there may be non-compliance going forward.</p>
Scenario 2	<p>Same facts as scenario 1, except the following:</p> <ul style="list-style-type: none"> ■ During February 2025, the entity anticipated that it may be in breach of covenant as at 31 March 2025. ■ It entered into an agreement dated 15 March 2025 with the lender whereby the lender agreed to waive covenant testing schedule on 31 March 2025. Hence, non-compliance with the covenant on 31 March 2025 will not give lender the right to demand payment. However, the lender will have a right to demand payment if there is any breach of covenant with scheduled testing for later dates. 	<p>The 31 March 2025 covenant has been waived/ removed prior to the reporting date. Hence, there is no non-compliance of debt covenants at the reporting date and the entity has the right to defer the settlement for at least 12 months at the reporting date. The amended IAS 1 is clear that the future covenants do not affect the classification of liability at the reporting date. Thus, the entity classifies the loan as non-current.</p>
Scenario 3	<p>Same facts as scenario 1, except the following:</p> <ul style="list-style-type: none"> ■ The entity did not comply the covenant as at 31 March 2025, giving the lender a right to demand immediate repayment. ■ On the same date, the lender agreed to waive the non-compliance and not to demand repayment basis non-compliance with the covenant on 31 March 2025. However, the lender will have a right to demand payment if there is any breach of covenant with scheduled testing for later dates. 	<p>The 31 March 2025 covenant non-compliance has been waived on or before the reporting date. Hence, the entity has right to defer the settlement for at least 12 months at the reporting date. The amended IAS 1 is clear that the future covenants do not affect classification of liability at the reporting date. Thus, the entity classifies the loan as non-current.</p>

Scenario 4	<p>Same facts as scenario 1, except the following:</p> <ul style="list-style-type: none"> ■ The entity did not comply the covenant as at 31 March 2025, giving the lender a right to demand immediate repayment. ■ On the same date, the lender agreed that it will not demand repayment for one month, i.e., till 30 April 2025, basis non-compliance with the covenant on 31 March 2025. ■ On 30 April 2025, the lender will test the covenant again. If the entity is in compliance with the covenant on 30 April 2025, the lender will not have a right early repayment. However, if the entity is non-compliant again on 30 April 2025, the lender will have a right to demand early repayment. ■ In addition, the lender will have a right to demand payment if there is any breach of covenant with scheduled testing for later dates. 	<p>The lender has agreed not to demand repayment pursuant to breach of covenant on 31 March 2025. However, the lender will again test compliance on 30 April 2025 and if the entity complies with the covenant on that date, the lender will not have right to demand early payment basis breach of covenant on 31 March 2025. Hence, in the instant case, the lender has effectively waived the non-compliance of debt covenant on 31 March 2025. However, it has inserted additional covenant to be tested on 30 April 2025.</p> <p>Considering the above, it may be argued that the entity has right to defer the settlement for at least 12 months at the reporting date. Such deferral is of course subject to compliance with covenants to be tested at future date/future covenants. The amended IAS 1 is clear that the future covenants do not affect classification of liability at the reporting date. Thus, the entity classifies the loan as non-current.</p>
Scenario 5	<p>Same facts as scenario 1, except the following:</p> <ul style="list-style-type: none"> ■ The entity did not comply the covenant as at 31 March 2025, giving the lender a right to demand immediate repayment. ■ On the same date, the lender agreed that it will not demand repayment for one month, i.e., till 30 April 2025, basis non-compliance with the covenant on 31 March 2025. The lender will review position again on 30 April 2025 and decide whether to demand early repayment or not. ■ In addition, the lender will have a right to demand payment if there is any breach of covenant with scheduled testing for later dates. 	<p>The lender has agreed not to demand repayment pursuant to breach of covenant on 31 March 2025. However, the lender has not waived the breach; rather, it has given a grace period of one month. Even if the entity complies with the covenant at the end of one month grace period, the lender may still decide to demand early payment basis breach of covenant on 31 March 2025. Hence, the entity does not have a right to defer the settlement for at least 12 months at the reporting date and the loan is classified as current.</p>
Scenario 6	<p>Same facts as scenario 1, except the following:</p> <ul style="list-style-type: none"> ■ The entity did not comply the covenant as at 31 March 2025, giving the lender a right to demand immediate repayment. ■ On 30 April 2025, the lender agreed to waive the non-compliance and not to demand repayment basis non-compliance with the covenant on 31 March 2025. ■ However, the lender will have a right to demand payment if there is any breach of covenant with scheduled testing for later dates. 	<p>The lender has agreed after the reporting date not to demand repayment pursuant to breach of covenant on 31 March 2025. At the reporting date, the entity does not have a right to defer the settlement for at least 12 months. Under IAS 1, waiver of covenant breach after the reporting date is treated as a non-adjusting event. Hence, the loan is classified as current.</p> <p>Under current version of Ind AS 1, waiver of covenant breach after the reporting date but before issue of financial statements is treated as an adjusting event. Hence, under the current version of Ind AS 1, the loan is classified as non-current. However, it may be noted that the ASB of the ICAI has proposed to remove this carve-out in the amended Ind AS 1.</p>

In the above scenarios, the application of amended IAS 1 on current vs. non-current classification is quite clear. As stated earlier, the pre-revised IAS 1 was not clear on future covenants and, therefore, it is possible that entities may have taken different views. It is imperative that these entities review positions taken in past carefully to align with the requirements of the amended IAS 1.

Example: Expected early settlement of loan

As at 31 March 2025, an entity has a loan repayable in five years from the reporting date. The entity is planning to pre-pay this loan in the next three months. The financial statements of the entity for the year ended 31 March 2025 will be authorized for issue on 31 May 2025.

In this case, the entity has a right to defer settlement for 12 months after the reporting date. The intention to prepay loan does not impact classification. Hence, the liability is classified as non-current.

Will it make a difference if the entity has prepaid the loan before the financial statements were authorized for issue?

The standard is clear that the classification is based on the right of the entity at the reporting date. Hence, the loan will still be classified as non-current. However, the entity will be required to disclose subsequent repayment as a non-adjusting event.

Will the position change if the entity has notified the bank of its intentions but has not entered into an irrevocable commitment to repay the loan within 12 months?

As stated above, the classification to be made is based on the right of the entity at the reporting date. Hence, the loan will still be classified as non-current. However, the entity should make appropriate disclosures regarding its intention to prepay the loan.

As compared to the above, if the entity has entered into a binding agreement with the bank for early settlement before reporting date and the said agreement is irrevocable, the entity no longer has the right to defer settlement for at least 12 months at the reporting date. In such a case, the loan is classified as current.



Settlement of a liability by issue of equity instruments

Prior to the amendments, the standard required that the terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments, do not affect its classification. As a result, a convertible instrument where the holder has the option to require convert to equity before maturity or at any time was classified as non-current if the maturity for cash settlement is greater than 12 months.

The amendments have removed the above clause, allowing entities to ignore early equity settlement at the option of the issue to decide the current vs. non-current classification. Rather, the amended standard requires that settlement through issuance of equity shares is also considered as settlement to decide of classification of liabilities as current or non-current. However, there is only one exception if the embedded equity conversion option itself is classified as an equity instrument based on principles laid down in IAS 32 *Financial Instruments: Presentation*.

How we see it

Many entities have issued convertible instruments which are either non-redeemable or redeemable at the end of a fixed period. However, the holder can opt to convert such instruments into a variable number of equity shares at any time. Earlier, such instruments were classified as non-current liability. Post-amendment, these instruments will be classified as a current liability.

Example

Query

An entity has issued optionally convertible redeemable preference shares (OCRPS). The OCRPS are redeemable after 10 years either generally or if there is no qualified initial public offer (IPO) by the end of 10th year. However, the holder can require the entity to convert OCRPS into equity shares at any time after the issuance date. Consider the following scenarios for the conversion formula:

- Scenario 1: The OCRPS are convertible into variable number of shares decided based on fair value of equity shares at the conversion date.
- Scenario 2: The OCRPS are convertible into a fixed number of shares decided upfront. However, the issuer has down-round protection, which can trigger a change in the number of shares to be issued on conversion if the entity issues new shares at lower than fair value.
- Scenario 3: The OCRPS are convertible into fixed number of shares decided upfront and there is no down-round protection or other clause which may change the number of shares to be issued on conversion.

How should the above instruments be classified in the balance sheet for year one to nine?

Response

Prior to the amendments, the terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification. Hence, one may argue that in all three scenarios, the holder option to require early conversion was ignored to decided current vs. non-classification. As a result, in the pre-amended standard, one may have classified OCRPS liability as non-current in the balance sheet for years one to nine.

Post amendment, the equity conversion option is ignored only if it is classified as equity under IAS 32. Hence, the below position will apply in the balance sheet for years one to nine:

- **Scenario 1:** Since the OCRPS are convertible into a variable number of shares decided based on fair value of equity shares at the conversion date, the equity conversion option is liability under IAS 32. Since the issuer can require settlement in variable number of shares at any time, the entire instrument is classified as current liability.
- **Scenario 2:** Though the OCRPS are convertible into fixed number of shares decided upfront, the number of equity shares to be issued in conversion could change due to the application of down-round protection clause. Considering that the host instrument itself is financial liability, even such conversion option does not meet fixed-for-fixed criterion to classify conversion option as equity under IAS 32. Rather, it is an embedded derivative. Under IFRS 9 *Financial Instruments*, the issuer entity may either measure the instrument as at fair value through profit or loss (FVTPL) or it can separate embedded derivative to be measured as at FVTPL and the host liability at amortized cost. Irrespective of the accounting followed, the conversion option is not treated as equity under IAS 32. This requires the issuer to classify the entire instrument (either measured as at fair value or liability at amortized cost plus embedded derivative components at fair value) to be classified as a current liability.
- **Scenario 3:** Since the OCRPS are convertible into fixed number of shares decided upfront and there is no down-round protection or other clause which may change number of shares to be issued on conversion, the conversion option is classified as equity under IAS 32. However, the issuer will classify the host instrument as financial liability. In this case, since embedded conversion option is ignored for deciding current vs. non-current classification. As a result, OCRPS liability is classified as non-current in the balance sheet for years one to nine.

It is obvious that the liability is classified as current in year 10 balance sheet in all the scenarios and both under pre-amended and post-amendment standards.

Disclosures

The amendments require an entity to provide detailed disclosure when a liability arising from a loan agreement is classified as non-current and the entity's right to defer settlement is contingent on compliance with future covenants within 12 months. The disclosures required include:

- (i) Information about the nature of the covenants, including:
 - a) The nature of covenants
 - b) When the entity is required to comply with them
 - c) The carrying amount of related liabilities
- (ii) If facts and circumstances indicate that an entity may have difficulty in complying with such covenants, those facts and circumstances must be disclosed. For this purpose, disclosures required may include facts such as below:
 - a) The entity has acted during or after the reporting period to avoid or mitigate a potential breach
 - b) The entity would not have complied with the covenants if they were to be assessed for compliance based on the entity's circumstances at the end of the reporting period



We believe the above disclosures are new for most entities. In the past, these entities were not making similar disclosures as there was no specific requirement and also, some of these entities considered information related to specific covenants to be confidential. Now, considering specific requirement, entities will need to make these disclosures. Consider an entity having a number of loan arrangement and each loan having many covenants. It may need to disclose a long list of covenants. We believe that the first disclosure is required in all cases where (a) loan liability is classified as non-current, and (b) it has one or more covenants requiring compliance in the next 12 months. This is irrespective of the fact that it may not foresee any particular difficulty in compliance.

With regard to the second disclosure, one may argue that the entities need to assess not only compliance up to the reporting date but also future scenario and identify if any difficulties are expected based on information available at the reporting date. If so, the same needs to be disclosed appropriately in the financial statements. In many cases, the disclosure of potential difficulties may imply that the lenders, the creditors and other stakeholders immediately become more cautious, which may pre-pone the potential issues and reduce the chances of mitigating those successfully. To avoid such scenarios, the entities may also want to disclose how they plan to mitigate potential issues. It is important that any such plan disclosure is verifiable and does not result in disclosure of prospective financial information.

Sample disclosure

Secured bank loan

This loan has been drawn down under a six-year multi-option facility (MOF). The loan is repayable within 12 months after the reporting date but has been classified as long term because the Group expects, and has the discretion, to exercise its rights under the MOF to refinance this funding. Such immediate replacement funding is available until 31 July 2029. The total amount repayable on maturity is INR3,500 million. The facility is secured by a first charge over certain of the Group's land and buildings, with a carrying value of INR5,000 million (31 March 2024: INR5,000 million).

The secured bank loan is subject to the following covenants:

- Interest cover ratio greater than five. The interest cover ratio in the secured bank loan is calculated as profit before tax divided by interests on debts and borrowings. The interest cover ratio was 11.1 as of 31 March 2025 (31 March 2024: 9.2).
- Gearing ratio below 45%. Gearing ratio is the entity's total debt (i.e., Interest-bearing loans and borrowings other than convertible preference shares) divided by its shareholder's equity. The gearing ratio was 26% as of 31 March 2025 (31 March 2024: 38%).

Both covenants are tested half-yearly as of 30 September and 31 March each year. The Group has no indication that it will have difficulty complying with these covenants.

Position under Ind AS

In the month of December 2022, the ASB of the ICAI has issued an Exposure Draft of proposed amendments to Ind AS 1 on the similar lines. In the Exposure Draft, the ASB has also proposed to remove two Carve-outs, which are explained above and provide some relief on current vs. non-current classification matter, in Ind AS 1 vis-à-vis the corresponding IAS 1. Based on the information available on the ICAI website, it appears that the Council of the ICAI has finalized these changes and submitted to the National Financial Reporting Authority (NFRA) for recommendation to the Ministry of Corporate Affairs (MCA). It also appears that the NFRA has cleared potential amendments to the Ind AS 1 and the final draft is pending with the MCA for notification. From the information available on the Website, whilst it is clear that the NFRA has recommended final amendments to the MCA notification, it is not clear what exactly those changes are. Particularly, it is also not clear that whether the two carve outs have been retained or removed. We believe that these aspects will be clear once final amendments to Ind AS 1 are notified.

It may be noted that the amendments under IAS 1 are applicable for annual periods beginning 1 January 2024. In the past, endeavor of the ICAI, the NFRA and the MCA has been to implement changes under Ind AS from similar dates and have minimal differences vis-à-vis the corresponding IFRS Accounting Standards. Considering the above, it is expected that the MCA may notify amendments on similar lines in a near future and these amendments may be applicable for financial year beginning on or after April 2024. Considering this, it is imperative that the entities evaluate the impact of potential changes and be prepared for implementing once they are notified.



05

Audit trail – Implementation challenges and learnings from first year



The Amendment in Rule 3(1) of the Companies (Accounts) Rules, 2014 (Accounts Rules) requires that all companies which uses accounting software for maintaining their books of account should use only such accounting software which has a feature of recording audit trail. This amendment is applicable from the financial year beginning on or after 01 April 2023. An audit trail has not been defined in the Companies Act, 2013 or in the Rules but the Implementation Guide on Reporting on Audit Trail issued by the Institute of Chartered Accountants of India (ICAI) defines it as a visible trail of evidence enabling one to trace information contained in statements or reports back to the original input source. Audit trails are a chronological record of the changes that have been made to the data. Any change to data including creating new data, updating or deleting data that must be recorded. This feature should remain enabled throughout the financial year and should record the audit trail of every transaction by creating an edit log of each change made in the books of account along with the date when such changes were made and who made such change. It should also be ensured that the trail cannot be disabled. Further, the audit trail is required to be preserved by the companies for a minimum period of eight years i.e. all the companies will be required to preserve the audit trail for the year ended March 2024 for a period of eight years and so on.

Primary responsibility for compliance with the Companies Accounts Rules - Management

Rule 3(1) of Companies (Accounts) Rules, 2014 puts onus on the management to comply with the provisions of the audit trail. It is their primary responsibility to ensure selection of the appropriate accounting software for maintaining its books of account, which has a feature of recording audit

trail of each and every transaction, creating an edit log of each change made in the books of account along with the date when such were made and ensuring that the audit trail cannot be disabled. To demonstrate that the audit trail feature was functional, operated and was not disabled, a company would have to design and implement specific internal controls (predominantly IT controls) which in turn, would be evaluated by the auditors, as appropriate. Further, management may decide to use a software which is maintained at a service organization.

Auditor's responsibility

Section 143(3) of the Companies Act, 2013 provides various matters on which auditors are required to report in their auditor's report. Clause (j) of Section 143(3) states that auditor's report shall also state such other matters as may be prescribed. Rule 11 of the Companies (Audit and Auditors) Rules, 2014 ('Audit Rules') specifies such other matters that are to be reported by the auditor. Rule 11(g) of the said Rules mandates the auditor to report on the following:

- whether the company has used such accounting software for maintaining its books of account, which has a feature of recording audit trail facility
- whether the same has been operated throughout the year for all transactions recorded in the software
- whether the audit trail feature has not been tampered with; and
- whether the audit trail has been preserved by the company as per the statutory requirements for record retention

First year of implementation of rule 3(1) of Companies (Accounts) Rules, 2014 and rule 11(g) of Companies (Audit and Auditors) Rules, 2014

First year of reporting has already been completed since the above amendment came into effect. The first year was a challenging year for some of the companies in terms of implementing the requirements of the Accounts Rules. Some of the challenges which led to reporting implications in the first year are summarized below :

Identification of software

Companies use multiple software within the entire business chain which have interface with the main accounting system and the robustness of these software varies depending on business needs, costs, etc. For processing salary, a company may use a software different from accounting of the same. The challenge comes in whether the software for processing salary also requires audit trail or not. Another example is POS system at the retail outlets, petrol pumps etc.

There would be many companies which operate as part of international chains. For e.g., a company in the business of hotels run by an international chain generally uses robust software created for room revenues, food, and beverage etc., which are tested centrally. Local companies which own the hotels may not be permitted to make any changes to this software and the extent of data visibility at the backend in terms of trails etc., may be visible only centrally at the Parent level of these operating international chains. It may be extremely difficult for local companies to get access to such data.

However, the ICAI guide provides that any software used to maintain books of account will be covered within the ambit of this rule. If sales are recorded in a standalone software and only consolidated entries are recorded monthly into the software used to maintain the general ledger, the sales software should also have the audit trail feature since sales invoice would be covered under books of account under section 2(13) of the Act. Therefore, reference was made to the definition of the books of account for identification of the software which should be covered within the ambit of audit trail provisions.

Use of end user computing files like spreadsheets

These tools generally don't have any audit trail feature. ICAI in its FAQs have clarified that "*If a company uses end-user computing tools, like spreadsheets, then those tools may be classified as accounting software if the same provides direct and auto feed to the accounting software (accounting software as identified by management). In such case, the spreadsheet should be treated as part of books of account and the spreadsheet will attract the audit trail requirement*".

ICAI guide included clarification on use of spreadsheets for maintenance of books of account which was referred to by the companies and auditors while reporting for the first year of audit trail provisions. However, the intent of the rules is to ensure that the companies use accounting software for maintenance of books of account which has a feature of audit trail in accordance with the requirement of the rules.

Maintenance of audit trail for database level changes

The Companies Act Rules do not define scope of the audit trail feature. Further, while it is expected that each accounting software has its own way of capturing audit trails, no uniform manner of recording audit trail has been mandated under law. Also, the requirement of maintaining audit trails is applicable to all transactions recorded in the software. The ICAI Guide includes database level changes under the ambit of such audit trail requirements, which caused challenge for companies to comply with the requirement to have audit trail for all transactions recorded in the software due to limitation in some of the software. It has been clarified in the guide that audit trail is required to be enabled at 'database' level even if access to database

in an ERP is restricted to only one user and log of such user making any such changes is enabled. The Guide envisages that changes made directly at the database level will impact the books of account and hence audit trail is required to be enabled at the database level also.

Some of the companies have represented that a complete audit trail is maintained in such ERPs for all changes carried out to the books of account (as well as other data) through the application interface. However, an enabling audit trail for all the tables at the database level often results in sub-optimal performance of the system, resulting in potential business disruption. Hence, audit trail is enabled for only for critical tables (which form part of the books of account) in the database while other tables are not enabled. While the management of the company may have put in place certain controls such as restricting access to the administrators and monitoring changes to configurations that may impact the audit trail, the auditor will be required to consider the requirement specified in the implementation guide for enablement of audit trail at 'database' level.

The absence of edit logs at the database level led to modifications in the report under the section 'Report on Other Legal and Regulatory Requirements'. Considering this will be the second year of implementation, companies are expected to better prepare for complying with these requirements. The auditors will consider the impact of the previous year's modification in the audit report for the current year.

Increasing costs of upgrades and storage

Considering the requirement of Section 128(5) of the Act, which requires books of account to be preserved by companies for a minimum period of eight years, the company would need to retain audit trail for a minimum period of eight years i.e., effective from the date of applicability of the Account Rules (i.e., April 1, 2023, onwards). Further FAQ 18 of the ICAI guide also states that "*The amended Rule 3 of the Companies (Accounts) Rules, 2014 requires that the back-up of books of account and other books and papers of the company maintained in electronic mode including at a place outside India, if any, shall be kept in servers physically located in India on a daily basis. These would include audit trail records as well since audit trail is required for books of account and the audit trail records would fall under the definition of books of account and other books and papers. Accordingly, audit trail records would require daily backup to be maintained in a server physically located in India.*" This will be quite challenging for small or medium-sized companies to maintain hundreds to thousands of logs on a daily basis, which could be lengthy to store as they increase in size.

The additional feature of the audit trail and retaining the audit logs for a period of eight years will lead to additional costs for the companies.



Many companies have chosen to provide a note relating to their responsibility on the compliance with the audit trail provisions in the notes to the financial statements for the financial year ending 31 March 2024. The notes also explain how they have implemented the requirements pertaining to Rule (3) of Accounts Rules. Such disclosures were referred to by the auditor while reporting (clean/modified) in the audit report under the section 'Report on Other Legal and Regulatory Requirements'. Few examples of note included in the financial statements are given below:

Example 1

Pursuant to amendment by the Ministry of Corporate Affairs (MCA) in the Companies (Accounts) Rules 2014, the associate companies (XX Private Limited & YY Private Limited) are using accounting ERP systems for maintaining its books of account and other relevant books in electronic form in a server physically located in India for it to remain accessible in India at all times. Pursuant to amendment by the Ministry of Corporate Affairs (MCA) in the Companies Amendment Rules 2021, the company is using an accounting software for maintaining its books of account which has a feature of recording audit trail edit log facility and that has been operative throughout the financial year for all relevant transactions recorded in the software impacting books of account at application level.

Example 2

The Company has used accounting software for maintaining its books of account, which has a feature of recording audit trail (edit log) facility and the same has operated throughout the year for all relevant transactions recorded in the software. Further, there are no instance of audit trail feature being tampered.

Example 3

As per Section 128 of the Companies Act, 2013 read with proviso to Rule 3(1) of the Companies (Accounts) Rules, 2014 with reference to use of accounting software by the Group for maintaining its books of account, has a feature of recording audit trail of each and every transaction, creating an edit log of each change made in the books of account along with the date when such change were made and ensuring that the audit trail cannot be disabled is applicable with effect from the financial year beginning on 1 April 2023. The Group uses an accounting software for maintaining its books of account which has a feature of recording audit trail (edit log) facility and the same has operated throughout the year for all relevant transactions recorded in the accounting software. However, the audit trail (edit logs) feature for any direct changes made at the database level was not

enabled for accounting software used for maintenance of books of account and other software used for processing financial information for XXX claims. The management has implemented recording of edit logs at database level for all accounting software w.e.f. April 2024, except for the software used for XXX information, for which management is attempting to migrate to a new accounting software in the financial year 2024-25.

Non-compliance with provisions of audit trail

Penal provisions

Non-compliance with the audit trail provision will attract penalty under section 128(6) of the Act. It is provided that if the managing director, the whole-time director, Chief Financial Officer or any other person of a company charged by the Board with the duty of complying with the provisions of this section, contravenes such provisions, such managing director, whole-time director in charge of finance, Chief Financial officer or such other person of the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to INR5 lakh.

Implications on auditor's reporting

The Institute of Chartered Accountants of India (ICAI) has issued an Implementation Guide on Reporting on Audit Trail under Rule 11(g) of the Companies (Audit and Auditors) Rules, 2014 which provides guidance for auditors to comply with the reporting requirements of Rule 11(g). In case the books of account are not maintained in accounting software having audit trail feature, or the audit trail feature remains non-functional during any part of the year, the auditor would need to appropriately modify the comment while reporting under Rule 11(g).

The same will also have an impact on reporting under Section 143(3)(b) of the Companies Act, 2013, wherein the auditor has to state whether the company has maintained proper books of account.

Also, the auditor needs to report any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith under section 143(3)(h) of the Act.

The ICAI Guide also provides for illustrative wordings of the audit report - unmodified and modified reporting.

What is next?

Since this is the second year of reporting, all companies should evaluate the challenges faced in the first year of reporting, ensuring that all new accounting software deployed during the year have the requisite functional parameters and attributes which would be considered as being compliant with the requirements and where it is necessary to engage with service providers to implement changes to ensure compliance. Management also needs to focus its attention on remediating the audit modifications relating to the audit trail during the first year of reporting and the impact of such modifications in the second year.

The intent of the regulator is clear – the integration of the audit trail in accounting software will not only help verify and track transactions but also make the whole system smooth and transparent.



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