Gist of amended Schedule III of CA, 2013

Highlights, implications and practical issues

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Introduction

The notification

Schedule III of the Companies Act, 2013, laying down the format for preparation of the financial statements, has been amended. The amendments have been effected by MCA notification no. G.S.R. 1022(E) dated 11th October, 2018[1], published in the Official Gazette[2] and effective from the date of the notification.

Broad contours of the amendment

The said notification causes several changes in Schedule III including changes in Division I and Division II. The most significant change is the insertion of Division III, prescribing the format for preparation of the financial statements for NBFCs to which IndAS is applicable.

Division I of Schedule III is applicable to all companies whose financial statements are to comply with the Companies (Accounting Standard) Rules, 2006, whereas Division II of the Schedule is applicable to all Companies whose financial statements are to comply with the Companies (Indian Accounting Standard) Rules, 2015. The new insertion, vide the notification, in the Schedule is Division III which will be applicable to all NBFCs on which Ind AS is applicable.

Purport/ impact of the amendment

The revised Schedule III brings several changes for non-banking non-financial companies, mainly in terms of classification of items such as trade payables, trade receivables and loan receivables.

Additionally, the amendment seeks to align the terminology of Schedule III with IndASes.

In case of NBFCs, while IndAS became applicable on NBFCs w.e.f. 1st April, 2018 fulfilling the prescribed criteria, the presentation of the financial results will now be aligned with the Indian

[1] http://www.mca.gov.in/Ministry/pdf/NotificationScheduleIII_12102018.pdf
[2] http://egazette.nic.in/WriteReadData/2018/191214.pdf

Accounting Standards. Several interesting questions arise on account of the applicability Division III which are critical, going forward, in the preparation of Financial Statements of these entities, which are discussed in detail in letter sections of this write up.

In respect of IndAS compliant NBFCs, the Schedule now adds a complete new Division, viz., Division III, laying down the format of Balance sheet, profit and loss a/c, statement of changes in shareholders' equity, and the disaggregation and other details in case of NBFCs.

Scope and date of applicability

Entities covered

Division III of Schedule III applies to a non-banking financial company ("NBFC") as defined in the Companies (Indian Accounting Standard) Rules, 2015[3] ("IndAS"). The said rules define an NBFC as follows:

> *"2. Definitions.*
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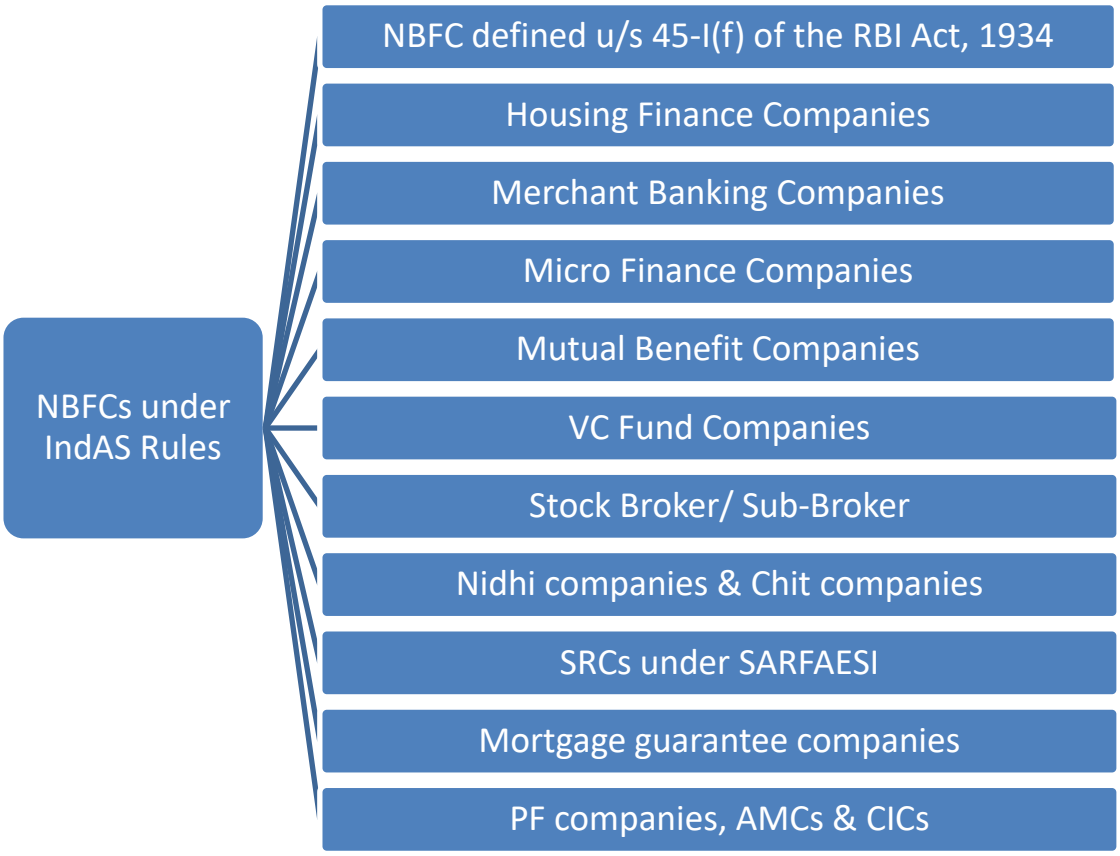
> *(g) Non-Banking Financial Company" means a Non-Banking Financial Company as defined in clause (f) of section 45-I of the Reserve Bank of India Act, 1934 and includes Housing Finance Companies, Merchant Banking companies, Micro Finance Companies, Mutual Benefit Companies, Venture Capital Fund Companies, Stock Broker or Sub-Broker Companies, Nidhi Companies, Chit Companies, Securitisation and Reconstruction Companies, Mortgage Guarantee Companies, Pension Fund Companies, Asset Management Companies and Core Investment Companies."*

As apparent from the above, the definition of NBFCs here is much wider in scope and covers not just NBFCs as defined under section 45-I of the Reserve Bank of India Act, 1934, but also various other financial entities and/ or intermediaries operating in the market. The aforesaid definition does not include banks, insurance companies and any other body corporate established under an Act of Parliament and hence, such entities shall not be required to follow Division III while preparing their Financial Statements.

[3] Inserted by Companies (Indian Accounting Standards) (Amendment) Rules, 2016, dated 30th March, 2016



Following companies are compulsorily required to comply with the Indian Accounting Standards for the accounting period beginning on or after 1st April, 2018, with comparatives for the period ending 31st March, 2018:

- NBFCs having net worth of INR 500 crores or more (whether listed or unlisted);
- Holding, subsidiary, JV or associate companies of the above NBFCs.

Subject matter of the amendment

Schedule III applies to 'Financial Statements'. The expression 'Financial Statements' is defined in sec. 2 (40) of the Companies Act, 2013 as follows:

> *"financial statement" in relation to a company, includes—*
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> > *(i) a **balance sheet** as at the end of the financial year;*
> > *(ii) a **profit and loss account**, or in the case of a company carrying on any activity not for profit, an **income and expenditure account**for the financial year;*
> > *(iii) **cash flow statement**for the financial year;*
> > *(iv) **a statement of changes in equity**, if applicable; and*
> > *(v) any **explanatory note** annexed to, or forming part of, any document referred to in sub-clause (i) to sub-clause (iv):*

Provided that the financial statement, with respect to One Person Company, small company and dormant company, may not include the cash flow statement;"

On perusal of the above definition, prima facie, Schedule III seems to be applicable only for annual financial statements. However, SEBI has mandated preparation of half yearly/ quarterly financial results in compliance with Schedule III, for both equity listed companies and debt listed companies via circulars dated 5th July, 2016[4] and 10th August, 2016[5], respectively.

In any case, half yearly financial results/ interim financial statements are intended to be progressive building blocks of the Annual Financial Statements. While the interim financial statements do not contain all the matters of details expected in the Annual Financial Statements, it will be appropriate to follow the same format as applicable in the case of Annual Financial Statements.

We can therefore infer the following:

- In case of listed companies (either equity listed or debt listed), all the companies, including NBFCs must compulsorily comply with Schedule III in preparation of half yearly/ quarterly financial results,
- In case of unlisted companies, the above requirement does not arise, since IndASes have not been extended to such companies so far.

Date of applicability

Since the notification has been issued in the Official Gazette, it is effective from the date of its publication, which is also the date of the notification, i.e. 11th October, 2018. Clearly, the notification is applicable for financial year 2018-19. With respect to the quarter/ half year ended 30th September, 2018 prepared by NBFCs, the listed entities should try to converge to the formats provided under Divisions III.

SEBI circular of 2016 granted additional time of 30 days in case of implementation of IndAS in the first year. Relevant provisions are reproduced hereunder:

***"Implementation of Ind-AS during the first year*:**

2.6.As mentioned in para 5 of the circular dated November 30, 2015, the comparatives filed alongwith the quarterly / annual financial results are required to be Ind-AS compliant. However, in order to facilitate smooth transition during the first year of Ind-AS implementation, the following relaxations are being given to the listed entities to which IndAS Rules are applicable from the accounting period beginning on or after April, 1, 2016:

[4] https://www.nseindia.com/corporates/content/Financial_Results_33.pdf
[5] https://www.sebi.gov.in/sebi_data/attachdocs/1470830193897.pdf

2.6.1. For the quarter ending June 30, 2016 and September 30, 2016:

(i) The timeline for submitting the financial results in compliance with the provisions of this Circular is extended by one month. The results for the quarter ending June 30, 2016 and September 30, 2016 may be submitted by September 14, 2016 and December 14, 2016 respectively.

(ii) For the quarter ending June 30, 2016, Ind-AS compliant financial results for the corresponding quarter ended June 30, 2015shall be provided. For the quarter ending September 30, 2016, Ind-AS compliant financial results for the corresponding year to date / quarter ended September 30, 2015 shall be provided. However, in such cases, limited review or audit of the same is not mandatory.

(iii) For the quarter ending June 30, 2016, submission of Ind-AS compliant financial
results for the preceding quarter and previous year ended March 31, 2016is not
mandatory. For the quarter ending September 30, 2016, submission of Ind-AScompliant financial results and Balance Sheet for the previous year ended March 31, 2016 is not mandatory. However, in case the entities intend to submit these results, the same may be without limited review or audit.

(iv) In such cases, the listed entities shall disclose with due prominence that the Ind-AS compliant financial results, pertaining to the relevant periods of the previous year as mentioned in (ii) and (iii) above, as applicable, have not been subjected to limited review or audit. However, the management has exercised necessary due diligence to ensure that the financial results provide a true and fair view of its affairs.

(v) The format of Balance Sheet for the Half-Yearly ended September 30, 2016 shall be as per the format for Balance Sheet (excluding notes and detailed sub classifications) as prescribed in Schedule III to the Companies Act, 2013.

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2.7. For listed entities to which Ind AS Rules are applicable in subsequent phases (beginning
from the Financial Year 2017-18, 2018-19 and 2019-20), the relaxations as mentioned in para 2.6 above shall mutatis-mutandis apply during their corresponding first year of Ind-AS
implementation."

Important issues

The pertinent question is whether those entities which already have approved Financial Statements for FY 20117-18 in place and are waiting to be filed should follow Division III? The answer should be clearly negative. The amendment does not seem to be retrospective in nature. It is applicable for FY 2018-19. For statements pertaining to previous financial year, which have already been approved, the same are not to be impacted by the change.

Another practical concern may surface with respect to XBRL. There is no corresponding circular/ notification of the stock exchange(s) w.r.t. re-mapping the XBRL formats wherein the financials have to be tagged and therefore, there may be a mis-match when the pdf uploaded by the company might not match with the readable format. However, this cannot be a reason for non-compliance. The resultant mis-matching needs to be appropriately be taken up with the stock exchanges so that necessary changes may be brought immediately.

In other cases where the company has already finalised the financials and the board meeting is lined up soon for approval of the same or cases where even the board has approved the financials, it may be practically not feasible for the company to draw up the financials again and re-schedule the board meeting for the purpose of implementing the amendments for the quarter ending September 2018.

Considering the cost involved in conducting board meetings, one may think of taking resolution passed by way of circulation. However, section 179(3) of the Companies Act, 2013 provides that there are some matters that cannot be passed by the board through video conferencing. Approval of financial statements of the company is one such matter that can only be passed in a board meeting where board members are present in person. Irrespective of the cost to be incurred by the company in conducting the board meeting all over again, finalization of accounts will have to be done again, with the board members present in person. However, for companies, which have already approved their financial statements, recalling a board meeting would be infeasible.

However, another argument could be relevant as companies which are already complaint of IndASes in preparation of their balance sheets, must not find it difficult to present their statements in terms of the revised Schedule III. The revised Schedule III is *per se* a mere alignment of IndAS with the presentation of Financial Statements. While companies have already prepared their financials based on the IndASes, and are lined up for board approvals for quarter ending September, 2018, may restructure the same based on the revised requirements.

Comparatives for period ending 31st March, 2018

Companies which are required to comply with the Indian Accounting Standards for accounting periods starting 1st April, 2018, or which have been complying with the said standards have to draw comparatives for period ending 31st March, 2018. Since the amended Schedule is applicable for financial year 2018-19, comparative figures for the preceding period must be in the revised format.

Substantive changes for non-banking non-financial companies

Highlight of changes in Schedule III – Division II pertaining to those companies which are required to comply with Indian Accounting Standards, other than NBFCs:

- Detailed classification of "trade payables" shall be as follows:
    - total outstanding dues of micro enterprises and small enterprises; and
    - total outstanding dues of creditors other than micro enterprises and small enterprises.
- Under the heading "Statement of Changes in Equity" for the words "Securities Premium Reserve", the words "Securities Premium" shall be substituted.
- Detailed classification of "trade receivables" shall be as follows:
    - Trade Receivables considered good - Secured;
    - Trade Receivables considered good - Unsecured;
    - Trade Receivables which have significant increase in Credit Risk; and
    - Trade Receivables - credit impaired.
- Classification of "Loan Receivables" as:
    - Loans Receivables considered good - Secured;
    - Loans Receivables considered good - Unsecured;
    - Loans Receivables which have significant increase in Credit Risk; and
    - (d) Loans Receivables - credit impaired

Substantive changes for NBFCs

The revised Schedule III – Division III brings about several changes for NBFCs in preparation of their Financial Statements, including the following:

- It shall be applicable to all NBFCs on which IndAS is applicable.
- The disclosure requirements specified in the Division shall be in addition to and not in substitution of disclosure requirements specified in IndAS. IndASes have been given overriding importance by Note 3 which states that as and when there are amendments to IndASes, the same shall be read into the Schedule. That is to say, in case of any conflict or additional detailing required by the applicable IndAS, the same shall apply irrespective of the format. Also is it laid by Note 2 that any disclosure requirements required by any other law/regulation shall remain unaffected.
- All other disclosures required by the Companies Act, 2013 shall be made in notes.
- The NBFCs preparing financial statements as per this Schedule may change the order of presentation of line items on the face of financial statements or order of line items within the schedules in order of liquidity, if appropriate, considering the operations performed by the NBFC. Notably, the format itself has provided liquid assets/ short-term liabilities on the top. This is appropriately in line with the nature of a financial business where liquidity plays important role. However, the traditional mindset is attuned to see long-term resources (for example, capital) on top, and therefore, entities are free to choose the order of long-term first.
- Terms used in this Division shall have the same meaning as assigned to them in the IndAS.

- Financial statements shall contain all comparatives i.e. financials of the corresponding preceding year.
- Format of all financial statements like Balance Sheet, P&L Account, Cash Flow Statement and has been provided in the Division.
- Disclosure relating to financial instruments invested into or issued by the reporting entity represents a significant portion of the revised financial statements for the non-banking financial companies. Some key highlights are:
    a. Ind AS 32 requires splitting of the financial liability and equity components in a compound financial instrument issued by the reporting entity. The equity component of the compound financial instrument has to be reported in the Other Equity schedule. In addition to the above, other comprehensive gains/ losses also have to be disclosed in this segment. Fair value changes designated at FVTPL have to be adjusted against retained earnings, since, retained earnings also form a part of Other Equity, fair valuation through profit and loss shall also have an impact of the same.

    b. Detailed disclosures regarding derivatives transactions entered into by the reporting entity has to be disclosed. The disclosures should also contain the fair value of the derivative instruments, this is in line with the fair valuation requirements under Ind AS. In addition to the above, the Schedule also requires the reporting entity to explain the use of derivative instruments.

    c. Receivables of the entity have to be classified into –
        i. Receivables considered good - Secured;
        ii. Receivables considered good - Unsecured;
        iii. Receivables which have significant increase in Credit Risk; and
        iv. Receivables - credit impaired

    One of the major requirements under the Ind AS 109 is the computation of expected credit losses of the reporting entity. This is largely different from the earlier model of incurred credit loss model which was followed by the financial entities in India or worldwide. In the expected credit loss model, the reporting entity has to assess the credit risks of its financial assets. If there is a substantial increase in the credit risk from what it was at the time of initial recognition, the reporting entity must provide for expected credit losses that could happen due to unfavourable events during the entire lifetime of the asset. If the credit risk does not increase significantly, the expected credit loss to be provided is based on unafvourable events that could take place in next 12 months.

    The classification of receivables in the manner provided above is largely in line with the ECL requirements and would give the readers of the financial statements an idea on how has expected credit losses been computed.

d. **Financial assets:** The reporting of financial assets has been divided into two parts, loans and financial investment.

   i. The loans have to be recorded based on the approach adopted for recognizing them on the books, that is, either under amortised cost method, fair value through other comprehensive income method or fair value through profit or loss method. The impairment loss provided on the loans has to be shown as well.

      Further, the loans have to be classified based on the following factors:

      1. Type of loan – Manner in which the loan has been extended, indicatively the schedule provides for bills purchased or discounted, loans repayable on demand, term loans, leasing and factoring. Another residuary class, as others, has been inserted to cover all such loans which otherwise do not feature in the remaining heads.
      2. Nature of the security in the loan – Whether the loan provided is a secured one or not would get captured here. Based on the natureof security, loans have to be classified between secured by tangible property, secured by intangible property, covered by bank/ guarantee and unsecured loans.
      3. Geographical location – Reporting entities will have to show separately the loans extended in India and outside India. For loans extended in India, loans to given to public sector have to be shown separately.

   ii. Like loans, investments also have to be recorded based on the approach adopted for the recognizing such financial instrument, that is, under amortised cost approach, fair value through other comprehensive income approach and fair value through profit or loss approach. In addition to the three major categories, there is an addition category which allows the reporting entity to capture instruments that are recognized in any other manner, for instance, Ind AS 32 allows, under certain circumstances, to record equity instruments at cost.

      The impairment losses provided against the investments also have to be reported separately here.

      Further, the loans have to be classified based on the following factors:

      1. Nature of instrument – The investments have to be recorded under the following heads – mutual funds, debt instruments, government securities, other approved securities and equity instruments. The equity instruments have to be further broken down based on the nature of the relationship between the investor and the investee, which is between subsidiary, associates, joint ventures and others.

2. Geographical location – Investments made in India and outside have to be shown separately.

e. **Financial liabilities**: The reporting of financial liabilities in the financial statements has been captured through the following –Debt securities, Borrowings (other than debt securities), Deposits, Subordinated liabilities and Other financial liabilities. Like financial assets, all the financial liabilities have to be recorded based on the approach adopted for the recognizing them on books, namely, amortised cost approach, fair value through other comprehensive approach or fair value through profit or loss approach.

   i. Debt securities –The debt securities shall capture the liability components of the compound financial instruments and such instruments which are purely financial liability separately. In addition, debt instruments also have to be classified based on the source of funding, that is, whether in India or from outside India.

   ii. Borrowings (other than debt securities) – These would basically represent the loan obligations undertaken by the reporting entity. Loans have to be classified based on their nature that is between, term loans, deferred payment liabilities, loans from related parties, finance lease obligations, liability components of compound financial instruments, loans repayable on demand. Any borrowing which fails to fall under any of the above must be captured under others.

   Additionally, like debt securities, the borrowings also have to be classified based on the sources of funds.

   Where the borrowings are secured in nature the same must be disclosed additionally. Even loans guaranteed by directors or others must be disclosed separately. The schedule also demands disclosure with respect to terms of repayment of the loans, thereby, giving the readers an idea of the future liabilities of the reporting entity.

   iii. Deposits – The deposits accepted from public, banks and others have to be shown separately.

   iv. Subordinated liabilities – This is a completely a new segment of reporting for the reporting entities and carries lot of significance for financial entities. The overall structure of the schedule is as such that any instrument which is subordinated to the claims of other liabilities but fails to qualify as an equity must be recorded under this head. Broadly, the schedule classifies subordinated liabilities between perpetual debt instruments to the extent they do not qualify as equity, preference shares other than those that qualify as equity and instruments other than the aforesaid. Financial entities in India are allowed to issue subordinated debt

instruments for the purpose of capital adequacy requirements, the same must be reported under this head.

In addition to aforesaid, the subordinated liabilities shall also have to be classified based on the source of raising funds.

v. Other financial liabilities: Financial liabilities which do not directly fall under any of the above and are incidental to the aforesaid fall under this category. Broadly, the same may be classified into Interest accrued, Unpaid dividends, Application money received for allotment of securities to the extent refundable and interest accrued thereon, Unpaid matured deposits and interest accrued thereon, Unpaid matured debentures and interest accrued thereon, Margin money and others.

Conclusion

Ideally, the revised Schedule III is intended to align the terminology of Financial Statements prepared as per Companies Act, 2013 with that of the Indian Accounting Standards. Several practical difficulties do exist in complying with the amendment right from quarter/ half year ended 31st March, 2018, however, these cannot be a reason for non-compliance. Adequate representation must be made to stock exchanges to make immediate changes in XBRL reporting.