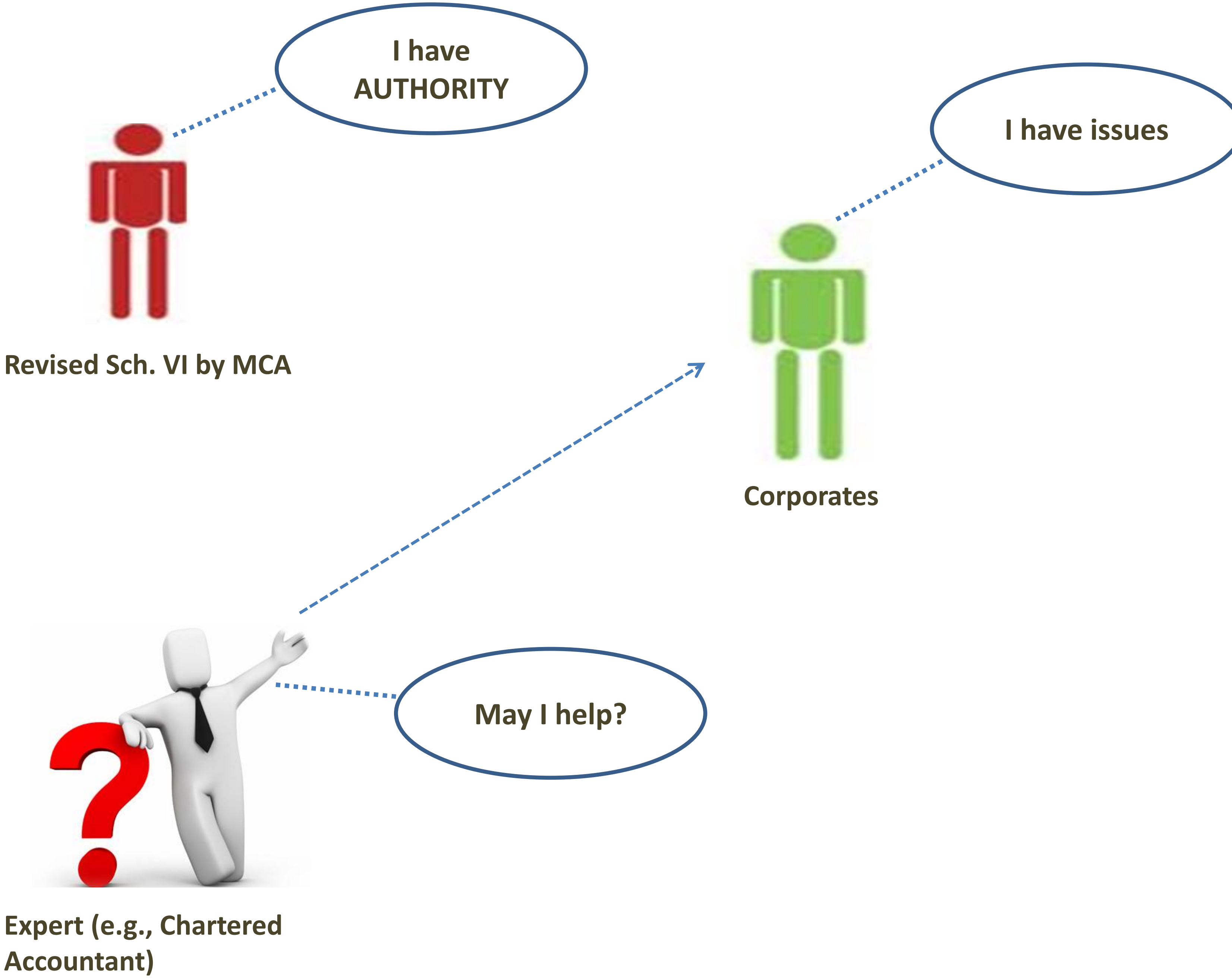
I have AUTHORITY
Revised Sch. VI by MCA
I have issues
Corporates
May I help?
Expert (e.g., Chartered Accountant)

(REVISED) SCHEDULE VI

C.R.I.T.I.C.A.L. I.S.S.U.E.S.

Keval Vakharia

Critical Issues *W.R.T.*

BALANCE SHEET

EQUITIES AND LIABILITIES
Shareholders' Funds Capital Reserve & Surplus Money Reserved against share warrants
Share Application money pending Allotment
Non Current Liabilities
Current Liabilities
TOTAL
ASSETS
Non-Current Assets Fixed Assets Non Current Investments/Assets
Current Assets
TOTAL

OPERATING CYCLE

<u>Simplified</u>

<u>The General Definition</u>

- The time gap between the acquisition of assets for processing and their realization in cash or cash equivalents is termed as “Operating Cycle”.

<u>Unidentifiable</u>

- In cases *<u>where it is not possible</u>* to identify the normal operating cycle, it is assumed as **twelve months**.

OPERATING CYCLE

Simplified

Practical Example

Formula for calculating Operating Cycle (OC):

OC = Days of Purchase + Days of sale, i.e.

Normal Credit period allowed by suppliers + Normal Credit period allowed to Customers

- Assume A & B are two distinct vendors
- Credit period allowed by Vendor A is 30 days, while that by Vendor B is 14 Months (425 days approx)
- Also, the normal Credit in the industry is 30 days
- The Credit period allowed to a Customer C is 25 days
- Using the above formula, we can say that

  Operating Cycle = 30 days + 25 days = 55 Days
- Therefore,
  - Payable to Vendor A => Current Liability
  - Payable to Vendor B => Non – Current Liability

OPERATING CYCLE

Simplified

Practical Example

- Now assume that the industry's normal Credit period is 14 Months
- Rest all factors remaining the same, the company's operating cycle shall be => 425 days + 25 days = 450 days
- Thus, payables to both – Vendor A & B, shall be included into current liabilities

OPERATING CYCLE

Simplified

Conclusion

- In the above example, it should also be noted that the items of balance sheet that are ***related to the company's operations*** shall only be classified into current even though it is expected to be realized after 12 Months (but before 14 months)
- This means that the portion of term loans taken from the banks which is maturing after "12 MONTHS" is to be taken into Non – Current Liabilities.
- But, for calculating the working capital loans, the maturity period must be extended to "14 MONTHS".
- Operating Cycle can be different for different business lines by a Company

OPERATING CYCLE

Simplified

Issues

Should an operating cycle be disclosed?

YES. As a matter of best practice, a company may disclose the same, especially if the same is more than 12 months. This disclosure will be particularly helpful to the users of financial statements, where determination of the operating cycle involves significant judgment and it is more than 12 months.

Also, though no separate disclosure requirement is mentioned in the guidance note to Revised schedule VI, it is highly recommended to disclose the items which are classified into current & Non-current based on Operating Cycle's criteria.

Disclosure by Ashok Leyland

All assets & liabilities have been classified as current or non-current as per the Company's normal operating cycle and other criteria set out in the Revised Schedule VI to the Companies Act, 1956. Based on the nature of products and the time between the acquisition of assets for processing and their realisation in cash and cash equivalents, the Company has determined its operating cycle as twelve months for the purpose of current - non current classification of assets and liabilities.

OPERATING CYCLE

Simplified

Other Issues

Is the credit period allowed by supplier reduced when determining the operating cycle?

In accordance with the Revised Schedule VI, operating cycle refers to Gross Operating Cycle, meaning thereby that the operating cycle should comprise the normal time spent on various activities, starting from purchase of raw material till realisation of cash and there is no need to reduce the credit period allowed by supplier from the same. Further, though the company has not paid for the raw material during the first six months, it might have started incurring expenses on other items such as labour and overhead costs. Hence, the credit period allowed by the supplier need not be reduced when determining the operating cycle.

OPERATING CYCLE

Simplified

Other Issues

Is the operating cycle to be considered customer-wise, especially where a large customer is provided a significantly different credit period?

The Revised Schedule VI and the Guidance Note on the Revised Schedule VI contemplates the company to identify its operating cycle for each of its businesses and not based on each of its customers. Hence, the operating cycle must be defined in terms of each business.

OPERATING CYCLE

Simplified

Other Points

- ***Industry Specific OCs :***
  - Manufacturing, Trading & Service Companies => To determine business-wise
  - Real Estate Companies => Can be determined project-wise
  - Finance Companies => Difficult to determine (to be assumed 12 months)

- ***Relevance of OC***

  - For the classification of :
  - Trade Receivables/Payables
  - Supplier/Customer advances
  - Certain Borrowings

- ***Non-relevance of OC:***

  - For the bifurcation of :
  - Certain Long-term borrowings, Investments, Other Liabilities & Assets such as Statutory dues, Advances to staff, Receivables from government, etc.

A company is preparing its financial statements in accordance with the Revised Schedule VI for the first time. For certain information required to be disclosed in the notes, the current year amounts are nil. For example, let us assume that there is no default in repayment of loan and interest existing as at the end of current year. Is the company required to present previous year figures for such notes? Alternatively, can it omit the previous year information since no disclosure is required in the current year?

Revised Schedule VI requires that "Except in the case of the first financial statements laid before the company (after its incorporation), the corresponding amounts (comparatives) for the immediately preceding reporting period for all items shown in the financial statements including notes shall also be given."

The objective of presenting comparative information is to help users of financial statements in understanding the trends and key changes vis-à-vis the previous period financial statements. The inter-period comparability of information assists users in taking their economic decisions. Hence, a company needs to present comparative information for disclosures required under Revised Schedule VI even if their current period amount is nil.

Loans Borrowed: Disclosure of T&C

In accordance with the Revised Schedule VI read with Guidance Note on the Revised Schedule VI, a company needs to disclose repayment terms of loans borrowed. These terms include period of maturity with respect to the balance sheet date, number and amount of installments due, applicable interest rate and other significant relevant terms. Can a company make these disclosures under appropriate range? For e.g., can it state that all its Medium Term Loans carry interest rate in the range of SBAR+1% to SBAR+3%"?

With regard to repayment terms, the Guidance Note states: "Disclosure of terms of repayment should be made preferably for each loan unless the repayment terms of individual loans within a category are similar, in which case, they may be aggregated."

From this, it is clear that aggregation is permissible for similar items (similar need not be exactly matching – it could be broadly within a range of closeness, which is reasonable for the given case and circumstance). Also, the intent is not to have all the interest terms explicitly stated because there could be operational sensitivities for companies to explicitly disclose such items. It is adequate in such cases to provide a range or an average as may be suitably appropriate in each case and circumstance.

Loans Borrowed: Rollover

How would a rollover / refinance arrangement entered for a loan, which was otherwise required to be repaid in six months, impact current / non-current classification of the loan? Consider three scenarios: (a) Rollover is with the same lender on the same terms, (b) Rollover is with the same lender but on substantially different terms, and (c) Rollover is with a different lender on similar / different terms.

In general, the classification of the loan will be based on the tenure of the loan. Thus, in all the above cases, if the original term of the loan is short term, the loan would be treated as only current, irrespective of the rollover/refinance arrangement. However, in exceptional cases, there may be a need to apply significant judgment on substance over form. In such cases, categorisation could vary as appropriate.

Provisions - Employee Benefits

In case of Provision for Gratuity and Leave Encashment, can current and non-current portions be bifurcated on the basis of Actuarial valuation?

The actuary should be specifically requested to indicate the current and non-current portions, based on which the disclosure is to be made.

Investments in Convertible Securities

How will a company classify its investment in preference shares, which are convertible into equity shares within one year from the balance sheet date? Will it classify the investment as a current asset or a non-current asset?

In accordance with the Revised Schedule VI, an investment realisable within 12 months from the reporting date is classified as a current asset. Such realisation should be in the form of cash or cash equivalents, rather than through conversion of one asset into another non-current asset. Hence, the company must classify such an investment as a non-current asset, unless it expects to sell the preference shares or the equity shares on conversion and realise cash within 12 months.

Investments in Convertible Securities

How does the aforesaid requirement affect the classification of items for say, a) convertible debt where the conversion option lies with the issuer, or b) mandatorily convertible debt instruments

For all such cases, conversion of a liability into equity should be considered as a means of settlement of the liability as defined in the Framework For the Preparation and Presentation of Financial Statements issued by ICAI. Accordingly, the timing of such settlement would also decide the classification of such liability in terms of Current or Non-current as defined in the Revised Schedule VI.

Investment in Subsidiaries

The term “trade investment” is normally understood “as an investment made by a company in shares or debentures of another company, to promote the trade or business of the first company”. Whether investment in subsidiary is to be classified as “trade investment” or “other investment” ?

Neither the RS VI, nor the GN on RS VI specify any classification for investment in subsidiaries. Hence, this will be a case where classification should be made based on professional judgment.

Following Companies ***have classified*** Investment in Subsidiaries as Trade Investments :

- TATA Steel
- TATA Power
- UltraTech Cement Ltd.

Following Companies ***have NOT classified*** Investment in Subsidiaries as Trade Investments :

- Infosys
- Reliance Industries Ltd.
- Asian Paints

Investment in Partnership Firms

- To be classified as both Current and Non-Current
  - Capital account balance: Non-current
  - Current account balance: Current
- If the FS of the partnership firm not made up to same date:
  - Gap cannot exceed 6 months
  - To consider un-audited amounts till BS date;
  - The above facts need to be specifically disclosed
- Names of the firms (with the names of all their partners, total capital and shares of each partner)
- Additional disclosures in Notes for:
  - Change in constitution of Firm.
  - If firm's accounts are not made up to the same date as the date of the company's Balance Sheet
- Specific disclosure required regarding:
  - Share of partner's in profits of the firm;
  - The total capital of the partnership firm in which the company is a partner;
  - Separate disclosure is required by reference to each partnership firm in which the company is a partner.

Investment in LLPs

LLP is a Body Corporate and not a partnership firm as envisaged under the Partnership Act, 1932. Hence, investment in LLP can't be disclosed under the head Investment in Partnership Firms. Also, disclosures pertaining to Investments in Partnership firms, not required for Investment in LLP.

Share of Profit/Loss in LLP:
- Does not automatically accrue to the partners (like a firm)
- LLP can carry forward profits (without transfer to partners)
- No entry can be passed in books of company till profits are transferred to the partners of the LLP

Miscellaneous Expenditure

Under RS VI, there is no line item like "Miscellaneous Expenditure" RS VI also does not contain any specific disclosure requirement for the unamortized portion of expense items. Since AS 26 does not apply to items such as "share issue expenses" and "incidental costs of borrowings", how can the unamortized portion of the above be disclosed?

These need to be classified as "**other current / non-current assets**", **depending on whether the amount** will be amortized in the next 12 months or thereafter.

Contingent Liabilities & Commitments

- **Other Commitments**
  - Additional requirement in RS VI
  - Scope of terminology very wide
  - AS per GN, it would include "*all expenditure related to contractual commitments apart from capital commitments such as commitments arising from long term contracts for purchase of raw material, employee contracts, lease commitments, sales, investments, etc.*"

- **Illustrative disclosure of Other Commitments**
  - Under lease obligations
  - Going concern support to group company
  - PE arrangement between Holding co, subsidiary, associate
  - Commitment to fund research projects, etc.

- **Disclosure by L & T Limited:**

  "Other commitments related to sales / procurements made in normal course of business are not disclosed to avoid excessive details."

Critical Issues

W.R.T.

STATEMENT OF PROFIT & LOSS

Profit & Loss Statement For The Year Ended 31st Mar '12

	Particulars	Note No.	Figures As On The End Of The Current Reporting Period	Figures As On The End Of The Previous Reporting Period
I	Revenue From Operations			
II	Other Income			
III	Total Revenue (I + II)			
IV	Expenses			
	Costs Of Material Consumed			
	Purchases Of Stock In Trade			
	Changes In Inventories Of Finished Goods , Work-In-Progress And Stock In Trade			
	Employee Benefits Expense			
	Finance Costs			
	Depreciation And Amortisation Expenses			
	Other Expenses			
	Total Expenses			
V	Profit Before Exceptional And Extraordinary Items And Tax (III - IV)			
VI	Exceptional Items			
VII	Profit Before Extraordinary Items And Tax (V-VI)			
VIII	Extraordinary Items			
IX	Profit Before Tax (VII - VIII)			
X	Tax Expense:			
	1. Current Tax			
	2. Deferred Tax			
XI	Profit/Loss For The Period From Continuing Operations (VII - VIII)			
XII	Profit/Loss From Discontinuing Operations			
XIII	Tax Expense Of Discontinuing Operations			
XIV	Profit/loss From Discontinuing Operations (After Tax) (XII - XIII)			
XV	Profit/Loss For The Period (XI + XIV)			
XVI	Earnings Per Equity Share:			
	(1) Basic			
	(2) Diluted			

Revenue from Operations – Other Operating Revenue vs. Other income

The term "**Other Operating Revenue**" is not defined by RS VI. It would include Revenue arising from a company's operating activities, i.e., either its principal or ancillary revenue-generating activities, but which is not revenue arising from the sale of products or rendering of services.

Whether a particular income constitutes "other operating revenue" or "other income" is to be decided based on the facts of each case and detailed understanding of the company's activities.

Following treated as "Other Operating Revenue":

- Sale of Carbon credits
- Dividend from Joint Venture/Subsidiary (*Since division operates part of its business through Subsidiaries/JVs, dividend income is taken as Operating Income – Prism Cements Ltd)*
- Insurance Claims and Indirect taxes claimed received – *Kansai Nerolac Paints Ltd.*

Revenue from Operations – Other Operating Revenue vs. Other income

Whether the following is "Other Operating Revenue" or "Other Income"?

- A Company engaged in manufacture and sale of industrial and consumer products also has one real estate arm.
- A consumer products company owns a 10 storeyed building. The company currently does not need one floor for its own use and has given the same temporarily on rent.
- Interest from customers on delayed payments
- Foreign Exchange Gains

Finance Costs

Finance costs to be bifurcated into:

(i) Interest cost

- Finance charges on finance lease to be included under interest cost.
- **Interest on shortfall in payment of advance tax should be classified as finance cost.**
- Penalties under income tax act which are compensatory in nature should be treated as interest cost.

(ii) Borrowing cost

Amortization of issue expenses and discounts as per AS-16 are to be included here. Commitment charges, loan processing charges, guarantee charges, loan facilitation charges, discounts/premium on borrowings, other ancillary costs incurred in connection with borrowings, or amortization of such costs to be included under 'Borrowing costs'.

➢***Point of Caution:*** All bank commission & charges should not be included in Borrowing Cost, but only those incurred in connection with borrowings should be included.

(iii) Net gain/loss on foreign currency transactions

Net exchange gain/loss on foreign currency borrowings to the extent considered as an adjustment to interest cost needs to be disclosed separately as finance cost

Critical Issues *W.R.T.* CASH FLOW STATEMENT

Cash Flow Statement Company XYZ FY Ended 31 Dec 2003		
all figures in USD		
Cash Flow From Operations		
Net Earnings		2,000,000
Additions to Cash		
Depreciation		10,000
Decrease in Accounts Receivable		15,000
Increase in Accounts Payable		15,000
Increase in Taxes Payable		2,000
Subtractions From Cash		
Increase in Inventory		(30,000)
Net Cash from Operations		2,012,000
Cash Flow From Investing		
Equipment		(500,000)
Cash Flow From Financing		
Notes Payable		10,000
Cash Flow for FY Ended 31 Dec 2003		**1,522,000**

How will the Revised Schedule VI impact presentation of Cash Flow Statement? The following issues need to be specifically considered for this:

(i) Revised Schedule VI requires presentation of line items, either on face or in the notes which are different vis-à-vis those required under pre-Revised Schedule VI. For e.g., Revised Schedule VI requires presentation of trade receivables as against sundry debtors required by pre-Revised Schedule VI. Is it mandatory for a company to present revised line items in the CFS also?

The line items / headings used in cash flow statement should be aligned with the nomenclature of the items used in financial statements.

In accordance with Guidance Note on the Revised Schedule VI, the terms “trade receivables” and “sundry debtors” can have different meanings. Hence, a company cannot present trade receivables in the balance sheet and show movement in sundry debtors” in cash flow statement. The cash flow statement should also refer to them as trade receivables.

(ii) As a part of working capital movement, is it mandatory to present a separate movement for current and non-current components? Also, as a part of investing and financing activities, is a company required to present cash inflows and outflows separately for current and non-current items?

AS 3 - Cash Flow Statement does not mandate such presentation. Nor is such presentation required in Revised Schedule VI or Guidance Note on the Revised Schedule VI. Hence, it is not mandatory for a company to present separate movement / inflows and outflows from current and non-current components of various line items separately.

Disclosures required under RS VI - Desired Sequence

- Balance Sheet
- Statement of Profit and Loss
- Cash Flow Statement
- Company Background (recommendatory)
- Significant Accounting Policies
- Notes pertaining to items appearing in the FS
- Other disclosures required as per RS VI
- Disclosures required as per notified AS
- Disclosures required under other statutes, ICAI, etc.
- A Note that previous year figures have been regrouped / reclassified wherever necessary.

Criticism about Revised Schedule VI

- The Economic Times in it's article dated 6th September, 2012, highlighted that "NEW RULES FOR COMPANY DISCLOSURE CAN WORSEN THE QUALITY OF INDUSTRIAL DATA".
- They justified the above phrase by raising a few criticisms about the revised schedule VI format.
- Companies are no longer mandated to reveal such quantitative information as installed capacity and production statistics on manufactures in their annual reports, to align reporting norms with global standards.
- Almost 60% of the net domestic product now originates in the unorganized sector, and without foolproof norms to tighten data-reporting requirements in industry, the quality of national statistics would be increasingly suspect. Hence there is a pressing need for proactive policy, including public-private partnerships for improved data quality.

Criticism about Revised Schedule VI

- ICAI's guidance note has clarified that the loan becomes current only if the lender recalls the debt.
- "Banks in India generally do not recall loans on concerns that they will have to show this as an NPA (non performing asset) on their books," said KPMG partner and global head of accounting advisory services Jamil Khatri. "Taking on a default in a covenant is generally added as a matter of abundant caution and banks generally do not demand repayment of loans on minor defaults of debt covenants".
- A Crisil report recently pointed out that with corporate defaults rising sharply, the current fiscal year will see Indian banks restructure about Rs 1 trillion worth of loans, an increase of 54% over last year.

Criticism about Revised Schedule VI

- Ernst & Young partner Dolphy D'Souza said the institute has gone a step further and included even large defaults. "In the guidance note they had clarified that minor breaches at the balance sheet date does not lead to classification of the loan as current unless the bankers have actually called the loan. The recent FAQs (frequently asked queries) issued extends this benefit even in case of major breaches. Worse still no disclosures of breaches of debt covenant is required in financial statements and hence investors will remain unaware," he added.

END OF SESSION


Thank you!