NANGIA & CO LLP

CHARTERED ACCOUNTANTS

Assurance Gazette

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Content

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Foreword

Welcome to the May 2024 edition of the Assurance Gazette! We are excited to bring you valuable insights into the amendments in Ind AS 1 and Block chain technology & its impact on Auditing. This Gazette offers valuable insights into the Impact of the amendment and provides you with an understanding of how to identify material accounting policies along with transformative potential of Block chain technology, addressing the opportunities and challenges it presents for the future of the profession.

In this edition, we also present the Expert Advisory Committee's opinion on the accounting treatment of additional capitalization resulting from arbitration awards and pre-project expenses awaiting fund approval within the framework of Indian Accounting Standards (Ind AS).

We are committed to keeping you informed about the latest developments in the accounting and auditing world. We strive to present complex information in a clear and accessible manner, empowering you to make informed decisions.

We encourage you to share your feedback and suggestions on topics you'd like us to explore in future editions. Your input is invaluable in helping us tailor our content to meet your evolving needs

Material Accounting Policy

Introduction

On March 31, 2023, the Ministry of Corporate Affairs (MCA) notified amendments to Indian Accounting Standard (Ind AS) 1, "Presentation of Financial Statements". The landscape of accounting policy disclosures is undergoing a significant transformation with the introduction of the Companies (Indian Accounting Standards) Amendment Rules, 2023. These amendments, effective for annual periods beginning on or after April 1, 2023, introduce a crucial shift in focus from disclosing “significant” accounting policies to disclosing “material” accounting policy information. This change aligns Indian Accounting Standards (Ind AS) with International Accounting Standards (IAS) and aims to enhance the usefulness of financial statements for users.

Material Accounting Policy

The revised Ind AS 1 introduces the concept of materiality specifically within the context of accounting policy disclosures. As per the amendment in Ind AS 1 “Accounting policy information is material if, when considered together with other information included in an entity’s financial statements, it can reasonably be expected to influence decisions that the primary users of general-purpose financial statements make on the basis of those financial statements.”

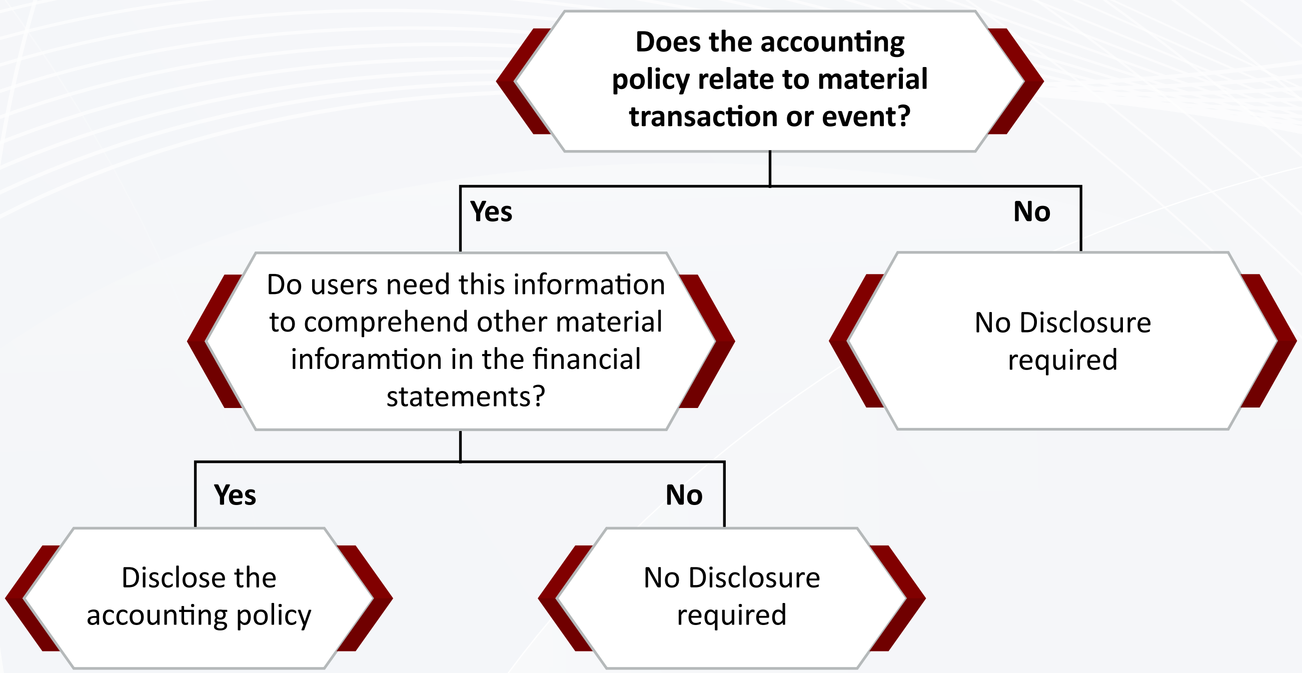
Accounting policy information is expected to be material if, without it, the users of the financial statements would be unable to understand other material information in the financial statements. Hence, entity-specific information about accounting policies would likely to be made in the financial statements.

Judgement in Applying Material Accounting Policies

Determining whether an accounting policy is material or not requires the use of judgement. We can consider the following factors to determine if the accounting policy information is material:

- Accounting Policy Choices
- Accounting Policies Developed under Ind AS 8
- Changes in Accounting Policy
- Significant Judgements and Estimates
- Complex Accounting
- Other Qualitative Factors

The below tree diagram will assist the entity to choose whether an accounting policy is material or not:



Disclosure Requirements for Immaterial Accounting Policies

Generally, when immaterial information is included in the financial statements, the amount of information may potentially reduce the transparency and usefulness of the financial statements because the material and relevant information becomes less prominent. As a result, immaterial accounting policy information need not be disclosed in financial statements. But, if it is disclosed, it should not obscure material accounting policy information.

It may be noted that an entity's conclusion that accounting policy information is immaterial does not affect the related disclosure requirements set out in other Ind ASs.

The below examples will help the entity in understanding the impact of changes from significant to material policy disclosure:

Significant Accounting Policy Disclosure	Material Accounting Policy Disclosure	Comments
Contract Assets Contract assets represent entity's right to consideration in exchange for goods or services transferred to the customer such that right is conditional on events and circumstances other than the passage of time. Contract assets are subject to impairment requirements of Ind AS 109 Financial Instruments.	A contract asset is initially recognized for revenue earned from construction services because the receipt of consideration is conditional on the successful completion of the construction of the project. Upon completion of the construction and acceptance by the customer, the amount recognized as contract assets is reclassified to trade receivables. Contract assets are subject to impairment assessment.	The existing policy on contract assets primarily summarizes requirements of Ind AS 115 and does not cover entity specific aspects. These aspects are more clearly highlighted in the revised policy.

Significant Accounting Policy Disclosure	Material Accounting Policy Disclosure	Comments
Borrowing Costs Borrowing costs include interest, amortisation of ancillary costs incurred in connection with the arrangement of borrowings and exchange differences arising from foreign currency borrowings to the extent they are regarded as an adjustment to the interest cost. Borrowing costs, if any, directly attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale are capitalized, if any. All other borrowing costs are expensed to the Statement of Profit and Loss in the period in which they occur.	No Disclosure is required.	The Company has taken short-term borrowings and the amount of borrowing cost is immaterial according to the financial statements. Hence, no disclosure is required.

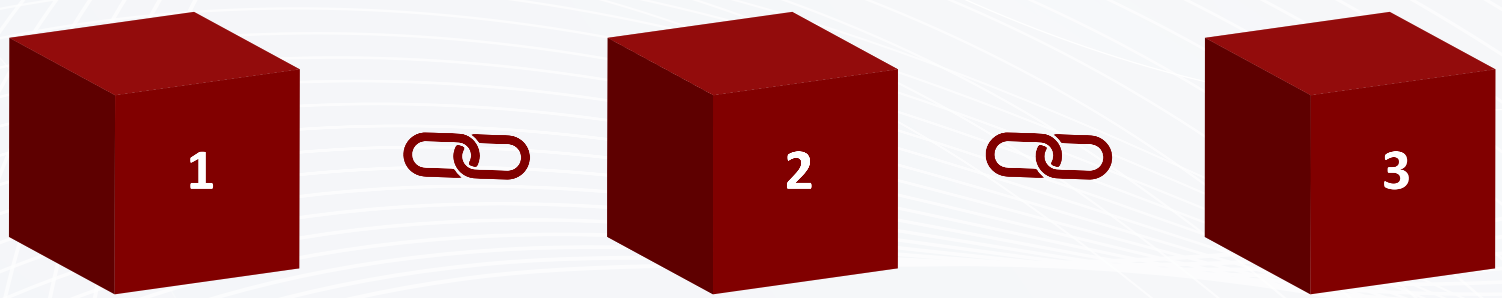
Nangia's Take

The amendments to Ind AS 1 represent a significant step towards enhancing transparency and clarity in financial reporting. By emphasizing materiality, providing clear criteria, and requiring disclosure of management judgments, the revised standard aims to improve the relevance and usefulness of accounting policy disclosures. Businesses need to adapt to these changes, ensuring compliance and effective communication with stakeholders. Determining whether accounting policies are material or not requires the use of judgement. There is no one-size-fits-all approach to disclosing material accounting policy information. Therefore, entities will have to revisit their accounting policy information disclosures when they first adopt the new amendments and the focus on Company-specific information should further discourage boilerplate disclosure.

Blockchain Technology And Its Impact On Auditing

A Blockchain consists of interconnected blocks holding data. Initially designed to timestamp digital records, preventing retroactive changes, it operates as a decentralized ledger accessible to all. Each block contains data, its hash, and the previous block's hash. The specifics of stored data vary based on the blockchain type.

Altering any content within a block results in a hash alteration, making hashes valuable for detecting block modifications. A modified hash signifies a distinct block, indicating any changes made.



Block 1	Block 2	Block 3
Hash: 1Z8F	**Hash:** 6BQ1	**Hash:** 3H4Q
Previous hash: 0000	**Previous hash:** 1Z8F	**Previous hash:** 6BQ1

Practical Aspect Of Blockchain In Accounting & Auditing As Well As Use Cases In Different Domains

Blockchain technology offers several practical applications in accounting and auditing, mainly due to its decentralized, immutable, and transparent nature. Here are some of the key practical aspects of blockchain in accounting and auditing:

A. Accounting Implications

1. Immutability ensures accurate and tamper-proof financial records, minimizing fraud risk.
2. Shared ledger enables access to financial data for authorized parties, streamlining processes.
3. Smart contracts automate routine tasks (invoices, payments, payroll), saving time and resources.
4. Reduced errors, improved efficiency, and automation lead to significant cost reductions.

B. Auditing Implications

1. Enables real-time transaction monitoring for risk management and ongoing assurance.
2. Transparent and tamper-proof records improve efficiency and effectiveness of audit procedures.
3. Aids in identifying anomalies and suspicious activities for better risk mitigation.
4. Smart contracts facilitate compliance with regulations and simplify reporting processes.

As Blockchain rapidly emerges as the leading technology for enhanced encryption, data storage, and processing efficiency, its application spans multiple domains. The following are some examples of its diverse use cases:

1. Supply Chain Management
2. Asset Management
3. Taxation and Revenue Collection
4. Forensic Accounting and Fraud Investigations

Blockchain's Impact on Auditors

Blockchain technology presents a paradigm shift for auditors, offering both exciting opportunities and complex challenges. Let's delve into the various ways this technology is reshaping the audit landscape:

A. Opportunities for Auditors

1. Blockchain’s immutability and transparency provides auditors with a complete and verifiable audit trail, reducing the risk of fraud and errors.
2. Real-time data access enables continuous auditing, allowing identification and mitigation of risks.
3. Automation of tasks (like verification and reconciliation) saves time and resources.
4. Blockchain allows auditors to analyze entire datasets rather than relying on sample-based testing, leading to more comprehensive and accurate audits.
5. Inherent control mechanisms allow auditors to prioritize evaluation of internal control effectiveness rather than performing extensive transactional testing.

B. Challenges for Auditors

1. Auditors need to develop new skills and knowledge to understand blockchain technology, its applications, and its implications for the audit process.
2. The technical complexity of blockchain systems can pose challenges in accessing and analyzing data, requiring specialized tools and expertise.

3. The lack of standardized practices and clear regulations creates challenges and complexity.
4. Auditors need to navigate privacy concerns related to accessing and handling sensitive data stored on blockchain systems.

Nangia's Take

- The emergence of blockchain technology presents a paradigm shift for the accounting and auditing profession. While it is still in its early stages of development and adoption, blockchain holds immense potential to transform traditional practices, offering significant opportunities to enhance efficiency, transparency, and trust in financial reporting.
- To thrive in this evolving landscape, auditors must embrace continuous learning and invest in developing expertise in blockchain technology. Collaboration with technology experts and active participation in shaping industry standards will be crucial in navigating the challenges and harnessing the opportunities presented by blockchain.

EAC Opinions

The Expert Advisory Committee (EAC) of the Institute of Chartered Accountants of India (ICAI) holds a pivotal position in the organization, serving as a crucial advisory body on matters pertaining to the accounting profession, financial reporting, auditing, and related domains. Its primary mandate is to offer expert counsel and direction on technical intricacies, ensuring that the standards, guidelines, and practices adhered to by chartered accountants align with international benchmarks and regulatory mandates.

Following are some of the important EAC opinions issued in recent months.

Query 1 Accounting treatment of additional capitalisation arisen due to arbitration award

Background

A steel-making PSU in India, engaged contractors to construct a blast furnace at one of its integrated steel plants. The project, originally scheduled for completion by April 1, 2011, faced delays, with commissioning occurring on October 17, 2014. Disputes arose regarding delays attributed to the contractor, leading to demands for liquidated damages. The contractor, however, contested the delays and raised claims for extra work, price variations, prolongation costs, and interest.

Arbitration under the International Chamber of Commerce ruled in favor of the contractor, resulting in awards totalling INR 710.99 crore plus interest. The Company challenged these awards in the Delhi High Court. Subsequently, a committee negotiated a settlement with the consortium, resulting in a final offer of INR 628.32 crore plus income tax.

After approval in February 2022, a settlement agreement was signed in March 2022, with the Company paying contractors INR 637.35 crore, covering prolongation costs, balance amount per contract, extra price variation claims, extra civil work, and additional design engineering costs.

Accounting Issue

The Company upon payment in March 2022, prolongation costs of INR 353.41 crore were expensed, while items totalling INR 283.94 crore were capitalized. Of this, a liability of INR 153.71 crore existed from 2014, with an additional INR 130.23 crore capitalized prospectively from March 2022.

The Comptroller and Auditor General of India (CAG) observed that the INR 130.23 crore capitalized in March 2022 represented payments for completed work before the asset's commissioning in 2014. CAG argued that depreciation should have been charged from the date of initial capitalization in 2014, not from the date of the addition.

The additional capitalization in March 2022 was due to extra price variation, civil work, and design engineering payments following the arbitration award. This was capitalized prospectively in line with Ind AS 16 and Ind AS 8. Adjustments were made to the asset's carrying amount as per accounting standards.

The Company maintained that its accounting treatment complied with Ind AS 16, Ind AS 8, and its existing accounting policy.

Query

The Expert Advisory Committee was asked to weigh in on two issues:

- The Comptroller and Auditor General's suggestion that it should be depreciated retrospectively from the original capitalization date.
- Whether the Company's accounting treatment, specifically the additional capitalization and depreciation methods, align with Ind AS 16, Ind AS 8, and the Company's accounting policy.

Points considered by the Committee

The Expert Advisory Committee focused on accounting for additional capitalization and depreciation stemming from extra price variation claim, extra civil work, and additional design engineering costs.

The Committee analyzed the criteria outlined in Ind AS 16 regarding Property, Plant, and Equipment. They highlighted that only costs directly associated with preparing the asset for operational use should be recognized as part of its cost. These costs include purchase price, expenses incurred to prepare the asset for intended use, and initial estimates for dismantling and restoration.

The Committee acknowledged that costs directly attributable to preparing Property, Plant, and Equipment (PPE) for operational use should be capitalized. They presume that the additional costs incurred for extra design engineering, civil work, and price variation claims, agreed upon by both management and the C&AG auditor, are directly attributable and hence can be capitalized as part of the asset's cost. These costs are presumed to pertain to the pre-capitalization period of the asset. Additionally, they recognize that the actual cost exceeded the initial estimate, constituting a change in estimate as per Ind AS 8. Consequently, the additional amount incurred due to this change should be capitalized prospectively, and subsequent depreciation should be charged accordingly. The resulting carrying amount should be assessed for impairment as per Ind AS 36. Therefore, the Company's accounting treatment aligns with the requirements of Ind AS 16 and Ind AS 8.

EAC opinion

Based on the foregoing analysis and within the framework of the presumptions, the Committee offers the following opinions regarding the matters raised:

- The incremental addition to the asset, amounting to INR 130.23 crore, should be subject to prospective depreciation.
- The accounting approach adopted by the Company concerning the additional capitalization and subsequent depreciation aligns with the stipulations delineated in Ind AS 16 and Ind AS 8.

Query 2 Accounting treatment of pre-project expenses for which fund approval is pending under Ind AS framework

Background

The Union Cabinet decided in 2004 to establish strategic crude oil reserves through a subsidiary company. The Company built crude oil storages at three locations, with capital costs provided by Oil Industry Development Board.

These storages are now operational. In July 2021, partial commercialization was approved, involving leasing/renting and sale of storage capacity. The Company also undertook Phase-II construction under PPP mode, incurring pre-project expenses funded by OIDB. However, the actual costs exceeded estimates, resulting in a shortfall of funds. The Company sought additional funds from Ministry of Petroleum and Natural Gas, and OIDB provided a shortfall after assurance to CA&G regarding liability depiction.

Accounting Issue

The Company's current accounting practice involves recognizing grants received from its shareholder, OIDB, as income in the profit and loss statement, corresponding to expenses incurred. However, there was a discrepancy in providing a liability for unpaid invoices due to uncertainty about the funding source. C&AG highlighted this omission, leading to understated liabilities and losses. The Company cited uncertainty about funding sources and the treatment of grants as reasons for not recognizing the liability. To resolve this, the Company planned to adjust its financial statements for the fiscal year 2022-23 based on clarified funding sources.

Query

The querist has requested the Expert Advisory Committee of the Institute of Chartered Accountants of India to provide guidance on two main issues regarding the Company's accounting practices:

- Whether the Company's decision not to make provisions for expenses incurred in the absence of a fund source, and the consequent omission of liability in the books of account, is appropriate.
- If deemed inappropriate, what alternative accounting or disclosure methods should the Company have adopted in such circumstances.

Points considered by the Committee

The committee focused on the timing of recognizing liability or provision for pre-project expenses incurred when there's uncertainty about funding. They examined this issue from an accounting perspective under Indian Accounting Standards (Ind AS). They noted that in the financial year 2021-22, the company didn't record any expenses or liabilities due to uncertainty about fund receipt and source. However, as the funding source is now identified, the company will reflect necessary income and expenses in its 2022-23 financial statements. They referenced Ind AS 1 and Ind AS 37, which dictate the recognition of income and expenses and the treatment of provisions and liabilities, respectively. Additionally, they highlighted the conceptual framework defining a liability as a present obligation resulting from past events and outlined criteria for its recognition.

The excerpt emphasizes the recognition of expenses in financial statements according to Indian Accounting Standards (Ind AS). It outlines that expenses are decreases in assets or increases in liabilities resulting in decreases in equity. Ind AS 1 mandates recognizing all expenses in the profit or loss statement unless specified otherwise. The Conceptual Framework defines liabilities as present obligations to transfer economic resources due to past events.

Furthermore, it explains that expenses arise from the incurrence of liabilities and should be recognized in the profit and loss statement unless Ind AS specifies otherwise. The text illustrates this with a scenario where costs escalated during pre-project activities, resulting in a liability. Despite receiving bills exceeding the sanctioned amount, disbursement was limited due to fund constraints, leading to an outstanding liability.

In this case, the committee asserts that when a company incurs expenses due to pre-project activities by suppliers, it creates a present obligation to pay them. Consequently, the company should recognize this obligation as a liability along with the corresponding expense in the profit and loss statement unless the expenditure qualifies for capitalization under relevant standards like Ind AS 16.

The committee enquired from the company for not recognizing these liabilities in the financial statements for the fiscal year 2021-22. They suggest rectifying this in the current reporting period as an error under Ind AS 8, which covers errors arising from omissions or misstatements in prior financial statements due to the failure to use reliable information available at the time of approval. Their suggestion should be made before issuing the financial statements.

The passage outlines procedures for correcting material errors discovered in prior financial statements. It explains that material errors may sometimes be identified only in subsequent periods, and these errors should be rectified in the comparative information presented in the financial statements for that subsequent period.

According to the guidelines, material prior period errors should be corrected retrospectively in the first set of financial statements approved for issue after their discovery. This correction involves either restating the comparative amounts for the period in which the error occurred or restating the opening balances of assets, liabilities, and equity if the error occurred before the earliest prior period presented.

Additionally, it highlights the definition of 'material' as provided in Ind AS 1, stating that information is material if omitting, misstating, or obscuring it could reasonably influence decisions made by the primary users of financial statements.

Opinion

Based on the preceding analysis, the Committee has reached the following conclusions regarding the matters outlined :

i. The current accounting approach adopted by the Company, which entails the omission of recognizing liabilities for incurred expenses in the financial statements for the fiscal year 2021-22, is deemed incorrect.

ii. The Company ought to have acknowledged a liability concerning pre-project expenses upon the execution of pre-project activities by suppliers, thereby generating an obligation for the Company to remit payment to the

Supplier. Given the Company's deviation from the prescribed accounting treatment, if this deviation proves to be material, it should be rectified in the ongoing reporting period, treating it as an error in accordance with the stipulations of Ind AS 8.

Nangia's Take

- The Expert Advisory Committee (EAC) opinions serve as invaluable resources for professionals in the accounting and auditing domains. They offer comprehensive guidance and advice on the practical application and implementation of accounting and auditing principles. EAC opinions help professionals navigate complex issues and ensure adherence to established standards and best practices in the field.

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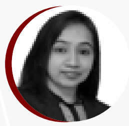

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