Assurance Gazette

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NANGIA & CO LLP
CHARTERED ACCOUNTANTS

Contents

Foreword

Welcome to the July 2024 edition of the Assurance Gazette! This edition delves into ICAI guidance notes that provide in-depth analysis and practical insights into the preparation and presentation of financial statements for Limited Liability Partnerships (LLPs) and Non-Corporate Entities. As these business structures are gaining momentum in India, ensuring accurate and transparent financial reporting becomes critical for building trust and attracting investment.

We hope this edition provides valuable insights and helps you navigate the complexities of financial reporting for LLPs and Non-Corporate Entities. Your feedback and suggestions are always welcome as we strive to bring you relevant and useful information in every edition of the Assurance Gazette.

Guidance Note on Limited Liability Partnerships and Non - Corporate Entities

Introduction

ICAI has released Guidance Note on Financial Statements of Limited Liability Partnerships and Guidance Note on Financial Statements for Non-Corporate Entities (collectively known as “**GNs**”). GNs are effective for financial statements covering periods beginning on or after April 1, 2024. These guidance notes aim to enhance the quality, comparability, and comprehensiveness of financial reporting by standardizing formats and providing clear guidance on the applicability of accounting standards. It aims to streamline the presentation of financial information and make it easier for stakeholders to understand and compare financial performance across entities. The technical guide on Financial Statements of Non- Corporate entities and LLP stands superseded by these Guidance Notes.

Further, ICAI has introduced excel file for illustrative formats for Financial Statements of LLPs and Non-Corporate Entities on its portal, aiming to streamline reporting processes and ensure accuracy in financial disclosures. These templates are designed to facilitate comprehensive and standardized reporting practices across these entities.

Parallel Points in GNs

Applicability of Accounting Standards

GNs specify the applicability of accounting standards to various entities, ensuring consistency and compliance with relevant regulations. GNs emphasize the importance of adhering to applicable accounting standards to maintain the integrity of financial reporting.

The Non-Corporate Entities Guidance Note offers broader coverage with less specificity, applicable to a wide range of non-corporate entities like Sole-proprietorship firms, HUF, Partnership Firms, Association of Persons, Trust and others. The LLP Guidance Note provides detailed guidance specifically for Limited Liability Partnerships.

Disclosure of Accounting Policies

GNs require disclosure of significant accounting policies. This helps users understand how the entity has prepared the financial statements.

Owners’ Funds / Partners’ Funds

GNs require detailed disclosures regarding owners’ funds or partners’ funds, including the number of units, par value, and any changes during the reporting period. This ensures transparency and provides stakeholders with a clear understanding of the entity's equity structure.

Trade Payables and Receivables

There is a requirement of detailed analysis for both payables and receivables. GNs defined the policies for handling overdue amounts must be clearly disclosed, allowing stakeholders to assess the entity's liquidity and credit risk.

Cash and Bank Balances

GNs have comprehensive reporting requirements on cash and bank balances, including details on cash equivalents and any restrictions on the use of these balances.

Provisions and Liabilities

GNs mandate detailed disclosures on provisions, contingent liabilities, and commitments. This includes the nature, timing, and uncertainties surrounding these items to ensure stakeholders are aware of potential future outflows and risks.

Profit and Loss

The requirements for the statement of profit and loss include detailed bifurcation of revenue recognition policies, and classification of expenses. This aims to provide a comprehensive view of the entity's financial performance.

Distinguishing Points in the Guidance Notes

Entity Structure

The LLP Guidance Note focuses on "Partners' Funds", which explicitly distinguishes between "Partners' Contribution" and "Partners' Current Account" under Partners' Funds, reflecting the specific structure of LLPs. While the Non-Corporate Entities Guidance Note uses "Owners' Funds " allowing for broader applicability to different entity types and uses more general terms like "Owners'/Partners' Capital Account" and "Owners'/Partners' Current Account" to accommodate various ownership structures.

Accounting Standards Applicability

The LLP Guidance Note applies uniform accounting standards to all LLPs whereas Non-Corporate Entities Guidance Note provides different levels of exemptions and relaxations based on the size and type of entity, classified into Level I, II, III, and IV.

Reporting Formats

The LLP Guidance Note prescribes specific formats for balance sheets, profit and loss statements, and cash flow statements tailored to the structure of LLPs. The Non-Corporate Entities Guidance Note provides different formats designed to cater to the varied needs of non-corporate entities.

Nangia's Take

The Guidance Notes including excel file for illustrative formats for financial statements represent a significant step towards improving financial reporting for LLPs and non-corporate entities. GNs promote a standardized and consistent approach, paving the way for increased investor confidence and access to capital for these entities. The focus on detailed disclosure requirements ensures a comprehensive understanding of financial health, while the streamlined reporting process simplifies compliance.

In the long run, these improved reporting standards are expected to enhance the credibility and transparency of these business structures in India.

Amendments to the Classification and Measurement of Financial Instruments- Proposed amendments to IFRS 9 and IFRS 7

Introduction

The International Accounting Standards Board (IASB) concluded its post-implementation review of the classification and measurement requirements of IFRS 9. The review identified several issues necessitating amendments to IFRS 9 and IFRS 7. The IASB proposed these amendments in an exposure draft (ED) titled ***"Amendments to the Classification and Measurement of Financial Instruments—Proposed Amendments to IFRS 9 and IFRS 7."***

The amendments are effective for annual reporting periods beginning on or after 1 January 2026 with earlier application permitted. An entity is required to apply the amendments **retrospectively**, in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, unless specified otherwise. **An entity is not required to restate prior periods.**

Amendments in the International Financial Reporting Standards (IFRS) 7 regarding the disclosure requirements for investments in equity instruments designated at Fair Value Through Other Comprehensive Income (FVTOCI).

1. **Disclosure of Fair Value Gains or Losses:**
    - Entities must disclose the fair value gain or loss presented in Other Comprehensive Income (OCI) during the reporting period.
    - This disclosure should separate the gains or losses into two categories:
    - Gains or losses from investments derecognised during the period.
    - Gains or losses from investments still held at the end of the period.

2. **Derecognised Investments:**
    - If an entity sells or otherwise derecognises equity investments measured at FVTOCI during the reporting period, it must disclose any transfers of the cumulative gain or loss within equity related to those derecognised investments.

3. **Reporting Date Fair Value:**
    - Previously, entities had to disclose the fair value of each equity instrument designated at FVTOCI as of the reporting date.
    - The amendments now allow this information to be provided by class of instruments rather than for each individual instrument.

New disclosure requirements for financial instruments with contractual terms that could alter the timing or amount of contractual cash flows due to contingent events.

1. **Contractual Terms and Contingent Events:**
    - Financial instruments may have contractual terms that allow the timing or amount of cash flows to change based on specific events.
    - These events may not be related directly to basic lending risks and costs like time value of money or credit risk.

2. **Disclosure Requirements:**

- Qualitative Description: Entities must provide a qualitative description of the nature of the contingent event. This means explaining what kind of event could trigger changes in cash flows.
- Quantitative Information: Entities need to offer quantitative information about the potential changes to contractual cash flows. This involves specifying how much the cash flows might change if the event occurs.
- Gross Carrying Amount and Amortised Cost: Entities must disclose the gross carrying amount of financial assets and the amortised cost of financial liabilities that are subject to these contractual terms.

3. **Classification of Disclosures:**

- These disclosures must be made by class of financial assets measured at either amortised cost or FVTOCI (Fair Value Through Other Comprehensive Income).
- Similarly, disclosures for financial liabilities should be made by class of financial liabilities measured at amortised cost.

Amendments to IFRS 9, which clarify the rules around the derecognition of a financial liability when it is settled through an electronic transfer.

1. **Existing Guidance:**

- According to the existing application guidance in IFRS 9, a financial liability is derecognised on its settlement date. This is when the liability is considered extinguished because the obligation specified in the contract is discharged, cancelled, or expires.

2. **New Amendment:**

    - The amendments offer an alternative to the existing requirement. An entity can consider a financial liability (or part of it) settled before the settlement date if it is settled in cash using an electronic payment system, provided certain conditions are met.

3. **Conditions for Early Derecognition:**

    - Irreversible Payment Instruction: The entity must have initiated a payment instruction that cannot be withdrawn, stopped, or cancelled.
    - Restricted Access to Cash: The entity must not have practical access to the cash intended for settlement due to the payment instruction.
    - Insignificant Settlement Risk: The risk associated with the electronic payment system must be insignificant. This means the transaction is expected to be completed through a standard administrative process, and the time between meeting the first two criteria and the cash being delivered to the counterparty is short.

4. **Settlement Risk:**

    - Definition: Settlement risk is the risk that a transaction will not be completed, meaning the debtor fails to deliver cash to the creditor on the settlement date.
    - Insignificance of Settlement Risk: Settlement risk is considered insignificant if the characteristics of the electronic payment system ensure the completion of the payment instruction follows a routine process with minimal delay. However, if the payment completion depends on the entity's ability to deliver cash on the settlement date, the settlement risk is not insignificant.

5. **Application Consistency**

- An entity that chooses to apply the derecognition alternative must apply it to all settlements made through the same electronic payment system.

Nangia's Take

Impact of Changes:

1. Clarity and Usefulness: The new amendments provide clearer and more useful information regarding the fair value gains or losses and equity movements for FVTOCI investments.
2. Simplified Reporting: Allowing fair value disclosure by class of instruments reduces the reporting burden on entities and streamlines financial information presentation.
3. Enhanced Transparency: Disclosing transfers of cumulative gain or loss for derecognized investments enhances transparency regarding equity movements.
4. Improved Disclosure: Entities must now disclose both qualitative and quantitative aspects of contingent events affecting cash flows.
5. Detailed Reporting: Enhanced requirements for reporting the gross carrying amount and amortized cost of affected financial instruments.
6. Classification Clarity: Clearer classification of disclosures by class of financial assets and liabilities.
7. Risk Assessment: Enhances understanding of credit risk concentration and payment prioritization in contractually linked instruments.
8. Practical Application: Offers practical examples and clear distinctions, making it easier for entities to apply the contractually linked instruments requirements consistently and accurately.
9. Defines the scope of application more precisely, including specific financial instruments and clarifying exclusions, aiding in accurate classification and measurement.

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