



# ASSURANCE GAZETTE

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# Foreword

This Assurance Gazette article provides insights into the Companies (Indian Accounting Standards) Second Amendment Rules, 2024, specifically addressing the revised Ind AS 116 on lease accounting. The amendments significantly impact sale and leaseback transactions, clarifying their financial reporting treatment. The article explains the key changes, including the prohibition on recognizing gains on retained assets, and offers a clear illustrative example to aid understanding and compliance. Further, this edition of Gazette also captures, the revised classification criteria for non-company entities regarding the applicability of Accounting Standards (AS). This assures streamlining the entity classification structure to ensure a more straightforward application of AS.



## ICAI Revises Classification Criteria for Non-Company Entities for Accounting Standards (AS)

### Introduction

The Institute of Chartered Accountants of India (ICAI) has revised the criteria for the classification of non-company entities for the applicability of Accounting Standards, effective for accounting periods commencing on or after April 1, 2024. Non-company entities are now categorized as Micro, Small, and Medium-Sized Entities (MSMEs) or Large Entities. The announcement also aligns terminology, replacing "Small and Medium Enterprises (SMEs)" with "MSMEs" and reclassifying Level I to Level IV entities under the new scheme. This revised framework supersedes the 2021 criteria announcement and earlier related guidelines, providing clarity and easing compliance for smaller non-company entities.

This announcement is not applicable to non-company entities that may be required to adhere to Indian Accounting Standards (Ind AS) or Accounting Standards (AS) as mandated by relevant regulatory requirements governing such entities.

## Key Updates

Two Categories	Micro, Small, and Medium-Sized Entities (MSMEs)	Large Entities
<b>Revised Classification</b>	Non-company entities without listed or listing-seeking equity or debt securities, excluding banks, financial institutions, and insurance companies, with annual turnover (excluding other income) of up to ₹250 crores and borrowings not exceeding ₹50 crores in the preceding year. They cannot be subsidiaries or holding entities of non-MSMEs.	Other than MSME
<b>Applicability of Standards</b>	Specific exemptions and relaxations	Must comply fully with all Accounting Standards
<b>Transitioning Between Categories</b>	Gaining MSME Status-Entities that newly qualify as MSMEs must remain so for two consecutive years before becoming eligible for any exemptions or relaxations.	Loss of MSME Status- If an entity no longer qualifies as an MSME in a given year, it must comply with the applicable standards for that period onward.
<b>Voluntary Full Compliance</b>	MSMEs may choose to fully comply with all standards, foregoing exemptions or relaxations. Partial compliance or selective disclosure is not allowed if it could mislead financial statement users.	Mandatory full compliance

## Applicability of Accounting Standards to Non-company Entities

AS	Particulars	Applicability to MSME
AS1	Disclosure of Accounting Policies	Applicable
AS2	Valuation of Inventories	Applicable
AS3	Cash Flow Statements	Not Applicable
AS4	Contingencies and Events Occurring After the Balance Sheet Date	Applicable
AS5	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies	Applicable
AS7	Construction Contracts	Applicable
AS9	Revenue Recognition	Applicable
AS10	Property, Plant and Equipment	Relaxations
AS11	The Effects of Changes in Foreign Exchange Rates	Relaxations
AS12	Accounting for Government Grants	Applicable
AS13	Accounting for Investments	Applicable
AS14	Accounting for Amalgamations	Not Applicable
AS15	Employee Benefits	Relaxations
AS16	Borrowing Costs	Applicable

AS	Particulars	Applicability to MSME
AS17	Segment Reporting	Not Applicable
AS18	Related Party Disclosures	Not Applicable to specified
AS19	Leases	Relaxations
AS20	Earnings Per Share	Applicable
AS21	Consolidated Financial Statements	Not Applicable to specified
AS22	Accounting for Taxes on Income	Relaxations
AS23	Accounting for Investments in Associates in Consolidated Financial Statements	Not Applicable to specified
AS24	Discontinuing Operations	Not Applicable
AS25	Interim Financial Reporting	Not Applicable to specified
AS26	Intangible Assets	Relaxations
AS27	Financial Reporting of Interests in Joint Ventures	Not Applicable
AS28	Impairment of Assets	Relaxations
AS29	Provisions, Contingent Liabilities and Contingent Assets	Relaxations





## Nangia's Take

ICAI stipulates that references to Level II, Level III, and Level IV entities in the Accounting Standards (AS) should now be interpreted as referring to "MSMEs," while references to Level I entities should be understood as "Large" entities.

The shift from a four-level classification (Levels I, II, III, and IV) to a simplified two-level classification (MSMEs and Large entities) by the ICAI brings several key simplifications:

1. **Streamlined Compliance Requirements:** By grouping entities into just two categories—MSMEs and Large entities—the ICAI has reduced the complexity of determining compliance requirements. Entities now have fewer criteria to assess, which makes it easier to quickly identify applicable standards.
2. **Clear Thresholds for MSMEs:** The new classification provides specific thresholds for turnover and borrowings to define an MSME, making it more straightforward for entities to self-assess their classification.
3. **Unified Standards for MSMEs:** Under the two-level system, MSMEs now encompass what were formerly Levels II, III, and IV. This unification allows for consistent application of standards across these smaller entities, reducing the need to interpret different standards for entities of similar scale.
4. **Ease of Interpretation:** Replacing Levels I, II, III, and IV with "Large" and "MSME" entities simplifies the language used in Accounting Standards. This reduces ambiguity and the likelihood of misinterpretation, as entities no longer need to distinguish between multiple, closely related categories.





## Ind AS 116: A Closer Look at the Amendments and an Illustrative Example

### Introduction

The Companies (Indian Accounting Standards) Second Amendment Rules, 2024, have brought certain changes to Ind AS 116, the standard governing lease accounting. These amendments, focusing primarily on sale and leaseback transactions, aim to enhance clarity and accuracy in financial reporting.

### Key Amendments in Ind AS 116

The core focus of the amendment is on sale and leaseback transactions, a common practice where a company sells an asset and then leases it back for continued use. The amendments introduce clearer guidelines on how these transactions should be reflected in financial statements, particularly concerning the right-of-use assets and lease liabilities.

A major change is the prohibition against recognizing gains or losses on the portion of the asset the seller-lessee retains for use. This ensures that companies cannot artificially boost their profits by recognizing gains on assets they still use, preventing manipulation of financial results and ensuring a more accurate reflection of a transaction's economic impact.

The amendment also introduces stricter rules on how lease payments and revised lease payments should be calculated. Companies must now ensure that their leaseback financial reporting reflects the right-of-use assets and lease liabilities in a balanced and consistent way, aligning the recognition of these payments with the actual economic value retained by the company.

These changes are set to take effect for annual reporting periods starting on or after April 1, 2024, giving businesses time to prepare for compliance while ensuring consistent application of the updated standards.

## An Illustrative Example: Fixed Lease Payments

The second amendment rules include illustrative examples to guide businesses in applying Ind AS 116 to specific situations. Let's delve into one such example involving fixed lease payments:

## Seller-Lessee Calculations (Fixed Lease Payments)

The second amendment rules include illustrative examples to guide businesses in applying Ind AS 116 to specific situations. Let's delve into one such example involving fixed lease payments:

Item	Calculation	Amount (₹)
Sale Proceeds of Building	Given	2,300,000
Original Cost of Building	Given	1,500,000
Fair Value of Building	Given	2,000,000
Fixed Annual Lease Payment	Given	180,000
Term/Period of lease	Given- 20 years	
Excess Sale Proceeds/ Financial Liability	Sale Proceeds - Fair Value of Building	300,000
Present Value of Lease Payments (Total)	Calculation based on 5% discount rate, 20 years	2,243,198
Present Value of Lease Payments (Portion related to lease) i.e. Lease Liability	2,243,198 - 300,000 (additional financing liability)	1,943,198
Gain on Sale of Building	2,000,000 - 1,500,000 (original cost)	500,000
Right-of-use Asset	$1,500,000 * (1,943,198 / 2,000,000)$	1,457,399
Gain on Rights Transferred to Buyer-Lessor	$500,000 * ((2,000,000 - 1,943,198) / 2,000,000)$	14,201

## Buyer-Lessor Calculations (Fixed Lease Payments)

The second amendment rules include illustrative examples to guide businesses in applying Ind AS 116 to specific situations. Let's delve into one such example involving fixed lease payments:

Item	Amount (₹)
Building	2,000,000
Cash	2,300,000
Financial Asset	300,000

## Implications for Businesses

These amendments bring a more structured approach to accounting for sale and leaseback transactions, preventing companies from inflating profits by recognizing gains on assets they continue to use. The prohibition against recognizing such gains promotes financial transparency and consistency across reporting periods.

The retrospective application of the changes requires companies to revisit past sale and leaseback agreements and make adjustments to their financial statements, ensuring consistency and compliance with the updated rules. Furthermore, the changes may also impact key financial metrics such as EBITDA.



### Nangia's Take

These amendments are part of an ongoing effort to improve financial reporting quality and reliability. Businesses must stay informed about these changes, adopt the necessary accounting practices, and ensure their financial reporting is accurate and transparent. By embracing these amendments, companies contribute to a more reliable and trustworthy financial reporting environment, benefiting both stakeholders and the public at large.



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