भारत सरकार / Government of India
राष्ट्रीय वित्तीय रिपोर्टिंग प्राधिकरण /National Financial Reporting Authority
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7th Floor, Hindustan Times House,
Kasturba Gandhi Marg, New Delhi

NF-25011/1/2023-O/o Secy-NFRA Dated 29.03.2023

Circular

To

1. **All listed companies**
2. **Unlisted companies specified in Rule 3 of NFRA Rules, 2018**
3. **Auditors of the above companies**

Subject: Instances of non-compliance with Indian Accounting Standards (Ind ASs) on Accounting Policies for measurement of Revenue from Contracts with Customers and Trade Receivables

As per sub-section 2(b) of section 132 of the Companies Act 2013 (the Act) read with rule 4(2)(c) of the National Financial Reporting Authority Rules 2018 (NFRA Rules 2018), the National Financial Reporting Authority is mandated to monitor and enforce compliance with accounting standards and auditing standards. Further, NFRA is required by sub-section 2(d) of section 132 of the Act read with rule 4(2) (g) of NFRA Rules, to perform such other functions and duties as may be necessary or incidental to the aforesaid functions and duties.

2. NFRA monitors compliance with accounting standards by Companies as part of its review of published financial statements of companies. During its recent review, instances of apparent non-compliance with the prescriptions of the Ind ASs in the critical areas of Revenue Recognition and Measurement, and Initial Measurement of corresponding Trade Receivables have come to light. In order to ensure adherence to high-quality Ind AS Reporting Framework, which is substantially aligned with globally accepted IFRS Standards, the instances of non-compliance are highlighted below for the urgent attention of the Company Management/Audit Committees and the Statutory Auditors.

Revenue from Contracts with Customers - Recognition and Measurement

3. Para 46 of Ind AS 115, Revenue from Contracts with Customers, requires that the entity shall recognise as revenue the amount of the transaction price, excluding the estimates of variable consideration that is allocated to that performance obligation. However, it has been noticed that the significant accounting policies disclosed by many companies wrongly state that revenue is recognised and measured at fair value of the consideration received or receivable. One example of such erroneous accounting policy of a large listed company[1], as observed by NFRA, states as follows:

"...Revenue is measured at the fair value of consideration received or receivable taking into account the amount of discounts, incentives, volume rebates, and outgoing taxes on Sales......."

However, there are several listed companies which correctly state their accounting policies in this regard. An example of correct accounting policy stated by a company is as follows:

"..Revenue towards satisfaction of a performance obligation is measured at the amount of transaction price (net of variable consideration) allocated to that performance obligation. The transaction price of goods sold and services rendered is net of variable consideration on account of

[1] Name of Companies withheld.

various discounts and schemes offered by the Company as part of the contract... "

4. Appendix A to Ind AS 115 defines the 'transaction price' as the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties. It is important to note that the transaction price defined in appendix A to Ind AS 115 is different from 'fair value' defined in Ind AS 113 and Ind AS 32, Financial Instruments: Presentation. Under Ind AS 115, the application of fair value is relevant only in a limited set of situations; for example, under para 66 of Ind AS 115, where the customer promises consideration in a form other than cash, an entity shall measure the non-cash consideration at fair value.

Trade Receivables – Initial Measurement

5. Trade receivables are financial assets within the scope of measurement requirements of Ind AS 109, Financial Instruments. All financial assets are required to be initially measured at fair value plus or minus the transaction costs. However, those financial assets classified as 'fair value through profit or loss' are required to be measured at fair value (para 5.1.1 of Ind AS 109). Further, as an exception to these principles, according to para 5.1.3 read with para 5.1.1 of Ind AS 109, financial assets in the form of trade receivables, shall be initially measured (initial recognition amount) at their transaction price (as defined in Ind AS 115) unless those contain a significant financing component determined in accordance with Ind AS 115 (or when the entity applies the practical expedient in accordance with para 63 of Ind AS 115).

6. It has, however, been noticed that many companies in their accounting policy, either stated separately for trade receivables or stated as part of the accounting policy for financial assets which include trade receivables, are erroneously stating that the trade receivables are initially recognized (or measured) at fair value, which is contrary to the requirements of Ind AS 109. One example of such erroneous accounting policy stated by a large listed company[2] is as follows:

"Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method less provision for impairment."

7. Further, there have also been instances of inconsistency between the accounting policy for initial measurement of trade receivables and the accounting policy for measurement of corresponding revenue leading to misleading and confusing information to the users of the financial statements. An example of such inconsistent accounting policy stated by a company is as follows

"Financial Assets

Initial Recognition and Measurement
All financial assets are recognized initially at fair value plus, in the case of financial assets not recorded at fair value through profit or loss, transaction costs that are attributable to the acquisition of the financial assets. These include trade receivables, cash and cash equivalents, other bank balances, fixed deposits with banks, investments, loans and other financial assets.... "

"Revenue Recognition
Revenue is recognized to depict the transfer of promised products or services to customers. Revenue is measured based on the consideration to which the Company expects to be entitled in a contract with a customer and excludes amount collected on behalf of third party. .. "

However, there are several listed companies which correctly state their accounting policy in this regard. One such example of a correct accounting policy disclosed by a company is as follows.

"Financial Assets

[2] Names of companies withheld

Initial Recognition and Measurement
..All financial assets are recognized initially at fair value, plus in the case of financial assets not recorded at fair value through profit or loss (FVTPL), transaction costs that are attributable to the acquisition of the financial asset...... However, trade receivables that do not contain a significant financing component are measured at transaction price."

"Revenue Recognition
..Revenue towards satisfaction of a performance obligation is measured at the amount of transaction price (net of variable consideration) allocated to that performance obligation. The transaction price of goods sold and services rendered is net of variable consideration on account of various discounts and schemes offered by the Company as part of the contract..."

8. The above instances of wrong accounting policies by a few companies reflect inadequate understanding of the measurement and disclosure requirements of the relevant Ind ASs. Accordingly, all listed companies and other entities falling with the domain of NFRA which are required to follow Ind ASs are hereby advised to comply with the provisions of Ind AS 115 and Ind AS 109, as discussed above. The auditors of these companies are required to ensure strict compliance, in the performance of their audits, with the provisions of the Ind ASs as brought out above.

9. Company Secretaries of the above companies are hereby requested to bring this circular to the notice of the Board of Directors.

10. This issues with the approval of the Executive Body, NFRA.

Vidhu Sood
(Vidhu Sood)
Secretary, NFRA

Copy to:

1. Secretary, Ministry of Corporate Affairs, Government of India
2. Director General of Corporate Affairs, Ministry of Corporate Affairs, Government of India
3. Governor, Reserve Bank of India
4. Chairperson, Securities and Exchange Board of India
5. Chairperson, Insurance Regulatory and Development Authority of India
6. President, The Institute of Chartered Accountants of India
7. President, The Institute of Company Secretaries of India
8. Director General, Confederation of Indian Industry (CII)
9. Director General, Federation of Indian Chamber of Commerce and Industry (FICCI)
10. Secretary General, The Associated Chambers of Commerce and Industry of India (ASSOCHAM)
11. Secretary General, PHD Chamber of Commerce and Industry (PHDCCI)
12. The CFO Board
13. Press Information Bureau, India