

भारत सरकार / Government of India
राष्ट्रीय वित्तीय रिपोर्टिंग प्राधिकरण / National Financial Reporting Authority

7th Floor, Hindustan Times House,
Kasturba Gandhi Marg, New Delhi

NF-25011/5/2022-O/o Secy-NFRA

Dated 20.10.2022

Circular

To

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

Subject: Non-Accrual of interest on borrowings by the companies in violation of Indian Accounting Standards

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 (NFRA) is mandated to monitor and enforce compliance with accounting standards and auditing standards. Further, the Executive Body of 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. It has come to the attention of the NFRA during proceedings under section 132(4) of the Act for professional misconduct of the statutory auditor (CA Som Prakash Aggarwal) of a listed company (Vikas WSP Limited), that the company in the Financial Statements of 2019-20, had discontinued accrual/recognition of interest expense on its bank borrowings, which had been reportedly classified as Non-Performing Asset (NPA) by the lender banks and for which the company was negotiating One Time Settlement with the banks. This accounting treatment was in contravention of the provisions of applicable accounting standard, as these borrowings as well the interest payable thereon continued to be the financial liabilities of the company and were required to be accounted for as amortized cost in accordance with the requirements of Indian Accounting Standard (Ind AS) 109, *Financial Instruments* (Ind AS 109). **Full details of the NFRA's Disciplinary Order in the above referred case of CA Som Prakash Aggarwal are available on NFRA website¹.**

3. The company's discontinuation of the recognition of accrual of interest while calculating the amortized cost of the borrowings was in violation of Effective Interest Method (EIM) and Effective Interest Rate (EIR) principles and concepts underpinning the Amortised Cost measurement. The Statutory auditor who was required to identify and question the company on this change in accounting treatment failed to do so and report this critical non-compliance to the shareholders.

4. It may be noted that the banks do discontinue, in their accounts, the recognition of interest income on the assets classified as NPAs based on prudential guidelines of RBI. However, these guidelines also require the banks to maintain a Memorandum Record of Accrued Interest on the NPAs clearly reflecting the fact that the bank has not legally released the borrowers from their contractual

¹ Refer NFRA Order u/s 132 (4) of Companies Act 2013 in case of CA Som Prakash Aggarwal

<https://nfra.gov.in/sites/default/files/Order%20Under%20Section%20132%284%29%20of%20the%20Companies%20Act%20in%20respect%20of%20Show%20Cause%20Notice%20Issued%20to%20CA%20Som%20Prakash%20Aggarwal%20%28ICA%20Membership%20No.%2074813%29%200.pdf>

liability to pay interest on their borrowings from the bank. This is the case even when the bank writes off loans for accounting purposes (called Technical Write-off) but continues to maintain memorandum records for pursuing its legal proceedings for recovery of its dues from the borrower. In this connection it is pertinent to bear in mind the prudent and stringent principles of Ind AS 109 for derecognition of any financial liability or part of it. Para 3.3.1 of Ind As 109 explicitly requires that financial liability shall be removed from the Balance Sheet *when, and only when, it is extinguished*. Para B3.3.1 further states that *a financial liability is extinguished only when the borrower is legally released from primary responsibility for the liability (or part of it) either by process of law or by the creditor*. In the present case, the banks had not released the company from the liability of the borrowing as well as the interest.


5. Ind AS 109 has specific accounting prescriptions as to how to account for the effect of revision in estimation of receipt and payment of cashflows other than changes in expected credit losses, whether/how to account for modification of contractual cash flows of financial liabilities, when to revise the EIR etc. Simply discontinuing interest expense accrual, that too unilaterally by the borrower company, is non-compliance with these specific prescriptions of Ind AS 109 resulting in erroneous measurement and presentation of Amortised Cost of a financial liability and the related interest expense in the Balance Sheet and Statement of Profit and Loss, respectively.

6. In view of the above reasons, discontinuation of interest expense recognition on financial liability solely based on the borrowing company's expectations of loan/interest waiver/concession without evidence of the legally enforceable contractual documents results in major non-compliance with the applicable accounting standards, compliance with which is mandated by the Act. In this regard, all concerned may also note the use of word "shall" in the language of the Ind AS, emphasizing their mandatory nature.

7. Accordingly, all companies which are required to follow Ind AS and their audit committees are hereby advised not to discontinue recognition of the principal or interest merely because of the borrowings being declared NPA or the Management's expectation of a likely settlement with or without concessions from the banks. The auditors are required to ensure strict compliance with this circular while performing audits.

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

9. This issues with the approval of the Executive Body.


Vidhu Sood
Secretary

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
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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. Press Information Bureau, India