Query No. 17

Subject: Disclosure of 'buyer's credit' and 'supplier's credit'.[1]

A. Facts of the Case

1. A company was incorporated as a 50:50 Joint Venture between ABC Ltd. and a foreign company. The company is engaged in the business of crushing of edible oil seeds, refining crude vegetable oils, manufacturing of vanaspati through hydrogenation and trading in edible oils and De-Oiled Cakes (DOC). The company also exports Castor oil and its De-Oiled Cakes. The facilities of the company are spread across 6 states. The company is a leading edible oil manufacturer in India with more than 85 stock points and 5,000 distributors catering to 1 million outlets. The company has a variety of products comprising a range of refined edible oils, vanaspati, bakery shortening and unrefined mustard oil.

2. The querist has stated that the company is also an importer of edible oils in India and finances its import in following ways:

(i) Cash Against Documents (CAD-DP/DA)

(ii) Buyer's Credit

(iii) Letter of Credit (LC or Suppliers Credit)

(iv) Buyer's Credit against 100% Fixed Deposit

[1] Opinion finalised by the Expert Advisory Committee on 10.10.2011.

The querist has further elaborated on Buyer's Credit and LC/Suppliers Credit in the following paragraphs.

Buyer's Credit

3. Under buyer's credit arrangement, loans are tied-up with a foreign bank by importer against the Letter of Undertaking (LoU) issued by an Indian bank. Under buyer's credit, the foreign bank pays directly to supplier and on maturity, the importer pays to the foreign bank through LOU issuing bank. The flow of transaction and corresponding accounting entries have been stated by the querist as under:

Flow	*Accounting entries*
Import documents received at Indian bank's counter.	--
Importer gives acceptance to Indian bank to pay on due date (DP/DA).	Creditors are booked in the books.
Importer ties-up funds with foreign bank for financing the import payment on due date.	--
Importer approaches Indian bank to issue LOU to foreign bank.	--
Foreign bank pays to the creditor under loan arrangement.	Creditors are liquidated by booking buyer's credit liability in books of account.
On maturity of buyer's credit, importer pays to the foreign bank through LOU issuing bank along with interest.	Buyer's credit liability is liquidated against bank payment.

4. The querist has stated that in the case of the company, a consortium of banks has sanctioned working capital facility which includes buyer's credit. The entire working capital limits are secured with first charge over the current assets and second pari-passu charge over the

fixed assets ranking pari-passu inter-se. The charges so created are registered with the Registrar of Companies (ROC). The LOUs are issued against the said secured limits. In some cases, the buyer's credit is also issued against 100% margin money kept with the banks in the form of Fixed Deposit Receipts (FDRs) pledged. All the buyer's credits are issued for a maximum of 360 days from Bill of Lading (BL) date.

Letter of Credit (LC) /Suppliers' Credit

5. In this arrangement, an LC is being issued by an Indian bank favouring foreign suppliers advised through its bank. The suppliers obtain the finance against the said LC from a bank finalised by the importer. The flow of transaction and corresponding accounting entries have been stated by the querist as under:

Flow	*Accounting entries*
On application by importer, Indian bank issues LC.	--
Import documents received at Indian bank's counter.	--
Importer gives acceptance to Indian bank to pay on due date.	LC liability is booked in the books as 'Acceptances'. Supplier receives payment from discounting bank arranged by importer.
On maturity of LC, importer pays to the Indian bank along with interest who in turn pays to foreign bank.	LC liability (Acceptances) is liquidated against bank payment.

6. The querist has stated that in the case of the company, a consortium of banks has sanctioned working capital facility which includes letter of credit. The entire working capital limits are secured with first charge over the current assets and second pari-passu charge over the

fixed assets ranking pari-passu inter-se. The charges so created are registered with the ROC. The LCs are issued against the said secured limits. All the LCs are issued for a maximum of 360 days from BL date.

B. Query

7. On the basis of the above, the querist has sought the opinion of the Expert Advisory Committee considering the prevalent provisions/guidelines under the Foreign Exchange Management Act (FEMA) /Companies Act, 1956/Accounting Standards on the following issues:

(i) Whether Buyer's credit issued against limits is to be classified as 'Buyer's Credit' and shown under the schedule of 'Secured Loans' or to be shown under the 'Current Liabilities and Provisions'.

(ii) What would be the disclosure requirement for Buyers credit issued under 100% margin FDRs? Would these also be classified as 'Buyer's Credit' and shown under the schedule of 'Secured Loans' or to be shown under the 'Current Liabilities and Provisions'.

(iii) Whether LCs issued against secured limits and classified as 'Acceptances' to be shown under the schedule of 'Current Liabilities and Provisions' with a suitable note in Notes on Accounts for securities given to banks or whether it can be shown under the schedule of 'Secured Loans'.

C. Points considered by the Committee

8. The Committee notes that the basic issue raised in the query relates to classification and disclosure of supplier's credit (LCs) and buyer's credit in the specific facts and circumstances of the case. Accordingly, the Committee has considered only this issue and has not considered any other issue arising from the Facts of the Case, such as, propriety of the various entries passed in respect of supplier's credit or buyer's credit in the books of the company, accounting for 'Cash

against Documents', etc. Further, the Committee has considered the query keeping in view only the general accounting principles involved and not from the angle of interpreting provisions of any legal enactments, such as, Foreign Exchange Management Act (FEMA), since as per Rule 2 of its Advisory Service Rules, the Committee cannot answer queries involving legal interpretation of various enactments.

9. The Committee also wishes to point out that as the querist has used the term 'Secured Loans' while raising the query, it is presumed that the query has been raised in respect of pre-revised Schedule VI (which is applicable till 31st March, 2011) to the Companies Act, 1956 since it is only in the pre-revised Schedule VI, the liabilities are distinctly classified into 'Secured Loans' and 'Current Liabilities and Provisions'.

10. The Committee notes the definition of the term 'Current Liability' as contained in the Guidance Note on the Terms Used in Financial Statements, issued by the Institute of Chartered Accountants of India, as below:

> "**3.35 Current Liability**
>
> *Liability* including loans, deposits and bank overdraft which falls due for payment in a relatively short period, normally not more than twelve months."

The Committee notes from the above that the definition of the term 'current liability' includes all liabilities, including those which are of the nature of loans, deposits, etc., that are payable within a period of twelve months. In the view of the Committee, it implies that the basis for *determining* a liability as 'current liability' as per the Guidance Note is the timing of its payment/repayment falling due irrespective of its disclosure as 'secured' or 'unsecured' liability (including loans), as per the requirements of pre-revised Schedule VI to the Companies Act, 1956.

11. The Committee further notes that in pre-revised Schedule VI, Part I – 'Form of Balance Sheet', on the liabilities side of the balance sheet under the head 'Unsecured Loans', there is an

item ‘short-term loans and advances’ for which note (d) has been given in the ‘General Instructions for Preparation of Balance Sheet’ at the end of the Form, which provides as follows:

> “(d) Short-term loans will include those which are due for not more than one year as at the date of the balance sheet.”

From the above, it is clear that as per the disclosure requirements of pre-revised Schedule VI, the primary bifurcation of liabilities is on the basis of whether the liabilities are secured or unsecured rather than on the basis of current or non-current liabilities. Thus, as per pre-revised Schedule VI, a liability which is of the nature of loans and borrowings will be *disclosed* under the head ‘Secured Loans’ or ‘Unsecured Loans’ even if it is a short term liability.

12. In the extant case, the Committee notes that both the buyer’s credit and supplier’s credit are payable within a period of less than a year and these are dues arising from purchase of raw materials/ goods in which the company deals. The Committee also notes that under the buyer’s credit arrangement, the importer is entering into financing arrangement with a foreign bank to make payments to the foreign supplier against the imports. Similarly, under the supplier’s credit arrangement, the importer enters into an arrangement with Indian bank to issue letter of credit (LC) in favour of foreign supplier who gets it discounted from a discounting bank, which is also arranged by importer. Further, the Committee notes that in the extant case, on maturity of LC, the importer is also incurring interest cost against the facility being extended to it. Thus, in this case, under the supplier’s credit also, the importer is the primary party who enters into financing arrangements to make payments to the foreign supplier. Accordingly, the Committee is of the view that both the buyer’s credit and supplier’s credit are primarily of the nature of loan taken by the importer.

13. On the basis of the above, the Committee is of the view that since both the buyer’s credit and supplier’s credit are of the nature of a ‘loan’ and are also secured by charge over current assets or secured against FDRs, these should be disclosed under the head ‘Secured Loans’ in the

balance sheet of the company as per the requirements of Schedule VI to the Companies Act, 1956.

14. As regards the classification and disclosure of the amounts due against buyer's credit and supplier's credit, the Committee is of the view that in the extant case, these should be classified and disclosed under the sub-head 'loans and advances from banks' under the head 'Secured Loans' using an appropriate nomenclature which would appropriately disclose their nature to the users of the financial statements.

D. Opinion

15. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 7 above:

(i), (ii) and (iii) The buyer's credit whether issued against limits or issued against 100% margin FDRs and supplier's credit/LCs issued against secured limits, in the extant case, should be classified and disclosed under the sub-head 'loans and advances from banks' under the head 'Secured Loans' using an appropriate nomenclature which would appropriately disclose their nature to the users of the financial statements as discussed in paragraphs 13 and 14 above.