Opinion

Disclosure of Impairment Loss on Long-Term Investments as Exceptional Item

The following is the opinion given by the Expert Advisory Committee of the ICAI in response to a query sent by a member. This is being published for the information of readers.

A. Facts of the Case

1. A company was incorporated on 16th August 1984 for procuring, transmission, processing and marketing of natural gas. The company has an authorised share capital of ₹ 2,000 crore, out of which ₹ 1,691.30 crore is paid-up share capital. The Government of India holds 54% equity of the company at present. The securities of the company are listed on National Stock Exchange, Bombay Stock Exchange and London Stock Exchange. At present, the company owns over 11,000 Kms of pipeline and currently transmits about 206 MMSCM per day of natural gas. The company operates six LPG manufacturing plants in different parts of the country with an installed capacity of 1.04 Million MT of LPG per annum. The company has an integrated petrochemical plant at Pata, Uttar Pradesh for manufacturing polymers. The company has world's longest pipeline from Jamnagar to Loni for transmission of LPG. The company has integrated its business activities and operates the City Gas Distribution, Exploration of Natural Gas, Wind Power & Solar Power Plant and Telecom Businesses.

2. The company has prepared its accounts as per Indian Accounting Standards (Ind ASs) w.e.f. 1st April 2016. In compliance with the Companies (Indian Accounting Standards) Rules, 2015, the company has prepared its financial statements for FY 2016-17 with comparative figures for FY 2015-16. The company has adjusted the impact of transition from Indian Generally Accepted Accounting Principles to Ind ASs in the opening reserve as on 1st April 2015 and in the statement of profit and loss for FY 2015-16. Further, the holding company, subsidiaries, joint ventures, or associate companies of the company have also made transition to Ind ASs w.e.f. 1st April 2016.

3. As per the provisions of Indian Accounting Standard (Ind AS) 36, 'Impairment of Assets', the company is conducting impairment test for investments in subsidiaries, associates and joint ventures that are accounted for at cost in the standalone financial statements. In line with the provisions of Ind AS 36, an impairment test is conducted, when internal and external indicators of potential impairment exist.

4. The company has an equity investment amounting to ₹ 974.31 crore, in a joint venture company, 'R', which is equivalent to 25.51% of the paid up equity capital of 'R' as on 31st March 2017. 'R' is in the process of restructuring its business by way of de-merger of its LNG business into a separate company effective from 1st January 2016. New company, viz., 'K' has been incorporated in 2015-16. The scheme of demerger w.e.f. 01.01.2016 has been approved by the Board of 'R', all the shareholders including the company and 'N', as well as by the majority of lenders and has been filed with National Company Law Tribunal for approval. 'R', along with its promoters, viz., the company and 'N', has carried out an assessment of impairment of 'R' as on 31st March 2017, considering the accumulated losses and restructuring of the business.

5. The impairment study of 'R' has been conducted on the basis of value in use, arrived at through the sum of present value of expected future cash flows of 'R' (both Power and LNG Block). Impairment study has been conducted over the economic life of assets. Based upon the

impairment study, the company has provided ₹ 783 crore in the books of account towards impairment loss in respect of carrying amount of equity investment in 'R' for the FY 2016-17.

6. The company also has an equity investment amounting to ₹ 8.10 crore in an associate company, 'F', an Egyptian company, which is equivalent to 19% of the paid up equity capital of 'F' as on 31st March 2017. In November 2016, Egyptian Government devalued the Egyptian Pound (EGP) which resulted in erosion of about 50% value of EGP vis-à-vis US Dollar. Considering the same, the company has carried out an assessment of impairment of its investment in 'F' as on 31st March 2017 and made provision of ₹ 5.04 crore in the books of account towards impairment loss in respect of the carrying amount of the investment in 'F' for the FY 2016-17.

7. The company has disclosed impairment loss on long-term investments as "Exceptional Item" on the face of the statement of profit and loss, considering the transaction as exceptional in nature as it is

   a) not the ordinary business activity;

   b) not being an item occurring on regular basis in due course of business; and

   c) not temporary in nature

   Further, it has also materially affected or substantially reduced the profit of the company.

8. Although the term "Exceptional Item" has not been defined in Ind ASs, however, paragraph 97 of Ind AS 1, 'Presentation of Financial Statements', requires that when items of income or expense are material, an entity shall disclose their nature and amount separately, either in the statement of profit and loss or in the Notes to Accounts.

9. Considering the above aspects and transaction not being the ordinary business activity and also not temporary in nature, the company has disclosed impairment loss on equity investment of long-term nature as "Exceptional Item" on the face of the statement of profit and loss for FY 2016-17.

10. The Comptroller & Auditor General of India ('C&AG') has conducted supplementary audit on the accounts of the company for FY 2016-17 under section 143(6) of the Companies Act, 2013. The C&AG, while conducting supplementary audit under section 143(6) of the Companies Act for the financial year 2016-17, has made observation on disclosure of impairment loss on long-term equity investments as an "Exceptional Item" on the face of statement of profit and loss. The C&AG was of the opinion that the impairment loss should be treated as an ordinary item and should not be considered as an "Exceptional Item" and disclosed as such.

11. It was submitted to the C&AG that the Institute of Chartered Accountants of India has issued Educational Material on Ind AS 1 and in response to Question No. 32 on treatment of "Exceptional Item", the educational material states that as per Ind AS 1, materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor. Considering the same and transaction not being the ordinary business activity, and also not temporary in nature, the Company has disclosed impairment loss on long-term investment as an "Exceptional Item" on the face of statement of profit and loss.

12. The C&AG, however, has not accepted company's/joint statutory auditors' replies. According to the C&AG, Accounting Standards categorically state that only the actual losses, which are permanent in nature and relate to ordinary activities, can be classified as "Exceptional Item", whereas the provision for impairment losses can be reversed in future as and when the financial condition of the entity is improved.

13. The provisional comment of the C&AG and the reply submitted by the company are as follows:

Provisional Comment	Reply
Exceptional Items: **Impairment of investment:** **₹ 788.04 crore** The above includes ₹ 788.04 crore on account of `provision for impairment loss against the equity investments in 'R' and 'F', Egypt. In this regard, it was observed that para 14 of AS-5 states that "Exceptional items are defined as those items which relate to entity's ordinary activities or permanent in nature like (i) abnormal losses on long term contract, (ii) litigation settlement, (iii) write off of expenditure capitalised on intangible assets other than amortisation and (iv) disposal of long-term investment. However, the above said impairment loss, as provided by the company, neither relates to its ordinary activities nor is permanent in nature; hence, does not qualify as an exceptional item. Management/Joint Statutory Auditors replied that impairment is an incident which is rarer than disposal, hence is surely in nature of exceptional item. Management's/Joint Statutory Auditors' replies are not acceptable as AS categorically stated that only the actual losses, which are permanent in nature and relate to its ordinary activities, can be classified as exceptional items whereas the provision for impairment losses can be reversed in future as and when the financial condition of the entity will be improved. Thus, it has resulted into overstatement of exceptional items (impairment loss) and profit before exceptional items and understatement of expenses (Depreciation and amortisation expenses) by ₹ 788.04 crore each.	It is submitted that 'Exceptional items' have not been defined in Ind AS. However, paragraph 97 of Ind AS 1 requires that when items of income or expense are material, an entity shall disclose their nature and amount separately. Institute of Chartered Accountant of India has also issued Educational Material on Ind AS 1 on Presentation of Financial Statements. In response to Question No 32 on treatment of exceptional items, the educational material states that as per Ind AS 1, materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor. As per paragraph 12 of existing Accounting Standard (AS) 5, Net profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies, when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately. As referred in AS-5 and pointed by the audit, profit / loss on disposal of Investment should be shown as exceptional item. In this regard, it is submitted that impairment is an incident which is rarer than disposal, hence is surely in nature of exceptional item. Generally, items of income or expense fulfilling the above mentioned criteria are classified as exceptional items and are disclosed separately. Thus, exceptional items are those items which meet the test of 'materiality' (size and nature) and the test of 'incidence'. The provision for impairment loss on equity investment disclosed as exceptional item includes provision against 'R' (₹ 783 crore) and 'F' (₹ 5.04 crore). It is further submitted that the Company has an equity investment amounting to ₹ 974.31 crore, in a joint venture company, 'R', which is equivalent to 25.51% of the paid up equity capital of 'R' as on 31st March 2017. 'R' is in the process of restructuring its business by way of de-merger of its LNG business into a separate company effective from 1st January 2016. New company namely 'K' has been incorporated in 2015-16. The scheme of demerger has been approved by the Board of 'R', all the shareholders including the company and 'N', as well as by the majority of lenders and has been filed with NCLT for approval.

Provisional Comment	Reply
	'R', the company and 'N' (co-promoter) have carried out an assessment of impairment of 'R' as on 31st March 2017, considering the restructuring of the business. The impairment study of 'R' has been conducted on the basis of value in use, arrived through sum of present value of future cash flows of 'R' (Power Block) for 22 years and LNG block for 20 Years. Impairment study has been conducted over the economic life of assets. Based upon the impairment study, the company has provided ₹ 783 crore in the books of account towards impairment loss on carrying value of investment in 'R' for the financial year 2016-17. Hence, the transaction is of exceptional nature not being an item occurring on regular in due course of business and substantially reduced the profit. The impairment study has been done covering substantial periods and it's not likely that the company will reverse the impairment losses in near future. Considering the same and transaction not being the ordinary business activity, and also not temporary in nature, it has been disclosed as Exceptional Item. Further, the Company has an equity investment amounting to ₹ 8.10 crore, in an Associate company, 'F', Egypt, which is equivalent to 19% of the paid up equity capital of 'F' as on 31st March 2017. In November 2016, Egyptian Government devalued the Egyptian currency which resulted in erosion of about 50% value of EGP vis-à-vis US Dollar. Considering the same, the company has carried out an assessment of impairment of its investment in 'F' as on 31st March 2017 and made provision of ₹ 5.04 crore in the books of account towards impairment loss on carrying value of investment in 'F' for the financial year 2016-17. The provision for impairment loss against investment in 'F' has been made due to devaluation of the Egyptian currency by Egypt Government and permanent in nature. Since, it is not the ordinary business activity and also permanent in nature, it has been disclosed as Exceptional Item. Without prejudice, it is also submitted that in the similar case, another Public Sector Undertaking ('N') has also disclosed the provision for loss on impairment as Exceptional item in financial statement. Thus, there is no overstatement of exceptional items (impairment loss) and profit before exceptional items and understatement of expenses (Depreciation and amortisation expenses) by ₹ 788.04 crore each. Considering above, Provisional Comment may please not be pursued further.

14. It may be mentioned that there is no specific guidance available on the matter in Ind AS 1 towards disclosure of "Exceptional Item", particularly of the nature described in general and herein above.

B. Query

15. In view of the above, the querist has sought the opinion of the Expert Advisory Committee on the following issues:

    (i) Whether the disclosure of ₹ 788.04 crore towards impairment loss of long-term equity investments as an "Exceptional Item" on the face of the statement of profit and loss for FY 2016-17 by the company for the reasons mentioned in paragraphs 7-9 above is correct as per Ind AS 1.

    (ii) In case the answer to (i) above is not in the affirmative, what should be the form and manner of disclosure for impairment loss of long-term equity investments in the financial statements of such nature and materiality.

C. Points considered by the Committee

16. The Committee notes that the basic issue raised by the querist relates to disclosure

of impairment loss on long-term equity investments in the joint venture company 'R' and the associate company 'F' as exceptional item on the face of the statement of profit and loss for the financial year 2016-17 in the context of Indian Accounting Standards (Ind ASs) notified under the Companies (Indian Accounting Standards) Rules, 2015 (hereinafter referred to as 'the Rules'). The Committee has, therefore, considered only this issue in the light of the Rules and has not examined any other issue that may be contained in the Facts of the Case, such as treatment under Accounting Standards notified under the Companies (Accounting Standards) Rules, 2006, adjustments on transition to Ind ASs, etc.

17. The Committee notes that Part II of Division II of Schedule III to the Companies Act, 2013 (hereinafter referred to as the 'Ind AS Schedule III'), which prescribes the format of statement of profit and loss applicable for companies adopting Ind ASs, requires presentation of 'Exceptional Items' as a separate line item in the statement of profit and loss. Further, Note 7 of the 'General Instructions for Preparation of Statement of Profit and Loss' applicable for companies adopting Ind ASs requires that a company should disclose by way of notes, additional information regarding aggregate expenditure and income on some items. One of the items to be disclosed in this regard is 'details of items of exceptional nature'. However, the term 'exceptional item' is not defined in 'Ind AS Schedule III'. Further, the term 'exceptional item' is neither defined nor used in Ind ASs.

18. Before proceeding to address the issue raised by the querist, the Committee notes the following paragraphs of Indian Accounting Standard (Ind AS) 1, 'Presentation of Financial Statements', notified under the Rules:

"31 Some Ind ASs specify information that is required to be included in the financial statements, which include the notes. An entity need not provide a specific disclosure required by an Ind AS if the information resulting from that disclosure is not material except when required by law. This is the case even if the Ind AS contains a list of specific requirements or describes them as minimum requirements. An entity shall also consider whether to provide additional disclosures when compliance with the specific requirements in Ind AS is insufficient to enable users of financial statements to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance."

"82 **In addition to items required by other Ind ASs, the profit or loss section of the statement of profit and loss shall include line items that present the following amounts for the period:**

……

(ba) impairment losses (including reversals of impairment losses or impairment gains) determined in accordance with Section 5.5 of Ind AS 109;

……"

"85 **An entity shall present additional line items, headings and subtotals in the statement of profit and loss, when such presentation is relevant to an understanding of the entity's financial performance.**

86 Because the effects of an entity's various activities, transactions and other events differ in frequency, potential for gain or loss and predictability, disclosing the components of financial performance assists users in understanding the financial performance achieved and in making projections of future financial performance. An entity includes additional line items in the statement of profit and loss, and it amends the descriptions used and the ordering of items when this is necessary to explain the elements of financial performance. An entity considers factors including materiality and the nature and function of the items of income and expense. For example, a financial institution may amend the descriptions to provide information that is relevant to the operations of a financial institution. An entity does not offset income and expense items unless the criteria in paragraph 32 are met."

"97 **When items of income or expense are material, an entity shall disclose their nature and amount separately.**

98 Circumstances that would give rise to the separate disclosure of items of income and expense include:

(a) write-downs of inventories to net realisable value or of property, plant and equipment to recoverable amount, as well as reversals of such write-downs;

(b) restructurings of the activities of an entity and reversals of any provisions for the costs of restructuring;

(c) .....

....."

Further, the Committee notes that the term 'material' is defined in paragraph 7 of Ind AS 1 as below:

> ***"Material*** **Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor."**

Further, the Committee notes that while paragraphs 97 and 98 are placed under the caption 'Information to be presented in the statement of profit and loss or in the notes' 'Ind AS Schedule III' requires presentation of 'exceptional items' as a separate line item in the statement of profit and loss with disclosure of individual items in the notes.

19. From the above, the Committee notes that subject to legal requirements, only material items need be presented as line items and/or disclosed in financial statements and this principle is applicable even for items mentioned in paragraph 82 of Ind AS 1 (as evident from paragraph 31 of Ind AS 1). The Committee notes that the querist has drawn attention to the Educational Material on Ind AS 1 issued by the Institute of Chartered Accountants of India on the meaning of 'Exceptional items' as per which it appears that all material items are not exceptional items and exceptional items are those items which meet the test of 'materiality' and 'incidence'. Definition of the term 'Material' as per paragraph 7 of Ind AS 1 is reproduced in paragraph 18 above. The Committee is of the view that 'incidence' refers to frequency of occurrence. Further, the Committee notes that 'Guidance Note on Division II-Ind AS-Schedule III to the Companies Act, 2013' (hereinafter referred to as 'the Guidance Note') issued by the Institute of Chartered Accountants of India deals with 'exceptional items'. While noting the absence of definition of the term 'exceptional items' in Ind ASs as well as 'Ind AS Schedule III', paragraph 9.6 of the Guidance Note states that Ind AS 1 has reference to such items in paragraphs 85, 86, 97 and 98 of that Standard.

20. Now the Committee addresses the issue of presentation/ disclosure of impairment loss on the long-term equity investments. In the extant case, the investments in the joint venture and associate are accounted for at cost in the standalone financial statements of the company, which is permitted by paragraph 10 of Ind AS 27, 'Separate Financial Statements', notified under the Rules. Hence, these investments are outside the scope of Ind AS 109, 'Financial Instruments', notified under the Rules. Consequently, the impairment of such investments is covered by Ind AS 36, 'Impairment of Assets', notified under the Rules, since, paragraph 2 of Ind AS 36 scopes out financial assets, only if they are within the scope of Ind AS 109. The Committee notes that Ind AS 36 does not deal with presentation of impairment loss in the statement of profit and loss. The Committee notes that paragraph 126 of Ind AS 36 states as follows:

> **"126 An entity shall disclose the following for each class of assets:**
>
> **(a) the amount of impairment losses recognised in profit or loss during the period and the line item(s) of the statement of profit and loss in which those impairment losses are included."**

Therefore, Ind AS 36 merely requires, *inter alia*, disclosure of the line item(s) of the statement of profit and loss in which the impairment losses are included. The Committee notes that while paragraph 82 of Ind AS 1 requires, inter alia, presentation of impairment losses (including reversals of impairment losses or impairment gains) determined in accordance with Section 5.5 of Ind AS 109 as a line item, it does not

specify a similar requirement for presentation of impairment losses determined in accordance with Ind AS 36. Further, the Committee notes that 'Ind AS Schedule III' does not specify impairment loss either as a separate line item in the statement of profit and loss or as part of any other line item. Hence, it is clear that only if the impairment loss on long-term investments is material, it is required to be disclosed separately as per paragraph 97 of Ind AS 1 (either on the face of the statement of profit and loss or in the notes) or is required to be presented as a separate line item in the statement of profit and loss in accordance with paragraph 85 of Ind AS 1. The Committee notes that item (a) cited in paragraph 98 of Ind AS 1 (reproduced in paragraph 18 above) represents impairment of inventories and property, plant and equipment and also reversals of such write-downs. These items are examples only. The Committee is of the view that impairment of long-term investments should also be disclosed, if material, as required by paragraph 98 of Ind AS 1. The issue whether such impairment loss can be presented as exceptional item is discussed in paragraph 21 below.

21. As stated in paragraph 19 above, an issue arises as to whether material items without any additional criteria can also be described as exceptional items. The Committee is of the view that this issue need not be examined, since, the querist's argument is that impairment loss in the extant case is *both* material and expected not to occur regularly. As stated by the querist in paragraph 7 above, in the extant case, the impairment loss has materially affected or substantially reduced the profit of the company. Assuming the correctness of these features, both the materiality and incidence tests are met. Consequently, based on the discussion so far made, the Committee is of the view that in the extant case impairment loss on the long-term equity investments can be presented as 'exceptional item' or part of exceptional items, if there is any other exceptional item, on the face of the statement of profit and loss, with disclosure of individual items in the notes to accounts in the latter case. The Committee also viewed that the disclosures as required by paragraph 126 of Ind AS 36, Impairment of Assets should be given.

22. The Committee does not agree with the views that the impairment loss is not related to ordinary activities. Further, an exceptional item can be an estimated amount (gain or loss) also and it need not be permanent. Mere possibility that the provision for impairment losses can be reversed in future as and when the financial condition of the entity will improve does not prevent it from its classification as an exceptional item. This is evident from the example of reversal of write-downs given in the Educational Material on Ind AS 1 and the Guidance, which is also found in paragraph 98 of Ind AS 1, reproduced in paragraph 18 above.

D. Opinion

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

    (i) The disclosure of impairment loss of long-term equity investments as an "Exceptional Item" on the face of the statement of profit and loss for F.Y. 2016-17 by the company in this case, appears to be appropriate, assuming that the querist's claim on materiality and incidence aspects and quantification of impairment loss are correct and if the disclosures as required by Ind AS 36, Impairment of Assets are appropriately given.

    (ii) See (i) above.

1.	The Opinion is only that of the Expert Advisory Committee and does not necessarily represent the Opinion of the Council of the Institute.
2.	The Opinion is based on the facts supplied and in the specific circumstances of the querist. The Committee finalised the Opinion on April 4-5, 2018. The Opinion must, therefore, be read in the light of any amendments and/or other developments subsequent to the issuance of Opinion by the Committee.
3.	The Compendium of Opinions containing the Opinions of Expert Advisory Committee has been published in thirty five volumes. A CD of Compendium of Opinions containing thirty five volumes has also been released by the Committee. These are available for sale at the Institute's office at New Delhi and its regional council offices at Mumbai, Chennai, Kolkata and Kanpur.
4.	Recent opinions of the Committee are available on the website of the Institute under the head 'Resources'.
5.	Opinions can be obtained from EAC as per its Advisory Service Rules which are available on the website of the ICAI, under the head 'Resources'. For further information, write to eac@icai.in. ■