

Diclosure of Partly Secured Bonds

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

A. Facts of the Case

1. A company is a wholly-owned, Government of India enterprise under the Ministry of Power. The company is a public financial institution and is also registered as a non-banking financial company (NBFC) with the Reserve Bank of India (RBI). The main activity of the company is to fund the various power sector projects in the country.
2. The querist has stated that the company, for meeting its financial needs, has been raising money through various sources. One of them is bonds. Some of the bonds raised by the company are guaranteed by the Government of India, some bonds are secured by mortgage of immovable property and hypothecation of book debts, and some are unsecured against which no security has been provided.
3. The company, for meeting its financial requirements, has also been permitted to raise Capital Gains Tax Exemption Bonds and Infrastructure Bonds under section 54EC and section 88 of the Income-tax Act, 1961. These bonds have a lock-in period as per the requirements of the Income-tax Act, 1961 and have been secured by providing mortgage of immovable properties, the value of which is less than the funds borrowed. As per the practice adopted by various companies, the company has been disclosing these bonds as 'secured borrowings' with a disclosure of the extent of the security provided. A

point has arisen that since the value of the security provided is not commensurate to quantum raised, whether these borrowings should be disclosed as 'unsecured loan' or 'secured loans'. Prima facie, the borrowings are neither fully secured nor unsecured. A copy of the annual report of the company for the financial year 2004-05 has also been provided by the querist for the perusal of the Committee. The querist has stated that Schedule 'C' on page 52 of the annual report indicates disclosure being made by the company in the balance sheet about factual position. The querist has provided the following extracts from the said Schedule:

"Capital Gains Tax Exemption Bonds are issued for a tenure of 5/7 years at different interest rates varying from 5.15% to 8.70% payable with 3 options, viz., semi-annual, annual and cumulative. These bonds have put option at par at any time and in case of Capital Gains Tax Exemption Bonds – Series-IV at the end of 3/5 years. Infrastructure Bonds are issued for a tenure of 3/5 years at different interest rates varying between 5.60% to 9.00% payable annually. These bonds have put option at par at the end of 36 months from the date of allotment and in case of Infrastructure Bonds – Series-IV at par at the end of 3/5 years. The Capital Gains Tax Exemption Bonds and Infrastructure Bonds are secured by a legal mortgage respectively over the company's immovable properties and receivable to the satisfaction of the trustees. The book

value of these immovable properties and receivables is Rs. 38.50 lakh. However, charge to the extent of amount borrowed has been created with the Registrar of Companies (ROC) in favour of trustees.”

4. According to the querist, the company has raised Capital Gains Tax Exemption Bonds to the extent of Rs. 7,750 crore as on 31.03.2005.

B. Query

5. The querist has sought the opinion of the Expert Advisory Committee as to whether such borrowings should be disclosed as ‘secured’ or ‘unsecured’ in the balance sheet of the company.

C. Points considered by the Committee

6. The Committee notes that the basic issue raised in the query relates to the disclosure of partly secured Capital Gains Tax Exemption Bonds as ‘secured’ or ‘unsecured’ loans as per the requirements of Schedule VI to the Companies Act, 1956, in the financial statements of the company. The Committee has, therefore, considered only this issue and has not examined any other issue that may arise from the ‘Facts of the Case’, for example, disclosure required by NBFC Prudential Norms (Reserve Bank) Directions, 1998.
7. The Committee notes the definition of

the term ‘secured loan’, as provided by paragraph 15.02 of the Guidance Note on Terms Used in Financial Statements, issued by the Institute of Chartered Accountants of India, which states as follows:

“15.02 Secured Loan

Loan secured wholly or partly against an *asset*.”

8. The Committee further notes from paragraph 3 of the Facts of the Case that the Capital Gains Tax Exemption Bonds have been partly secured by mortgage of immovable properties. Hence, the Committee is of the view that these bonds should be classified under ‘secured loans’, for the purpose of disclosure in the balance sheet as per the requirements of Schedule VI to the Companies Act, 1956. However, the nature of security should be clearly specified, as required by ‘Instructions in accordance with which liabilities should be made out’ of the said Schedule.

D. Opinion

9. On the basis of the above, the Committee is of the opinion, read with paragraph 6 above, that partly secured Capital Gains Tax Exemption Bonds should be disclosed under ‘secured loans’ along with a proper disclosure of the nature of security, as stated in paragraph 8 above.

Notes:

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 Compendium of Opinions containing the Opinions of Expert Advisory Committee has been published in twenty-four volumes which are available for sale at the Institute’s office at New Delhi and its regional council offices at Mumbai, Chennai, Kolkata and Kanpur.