Technical Guide on Preparation of Financial Statements under Cash Basis of Accounting

The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi

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FOREWORD

General Purpose Financial Statements prepared by the entity provide relevant and reliable information about the entity to its stakeholders for accountability and decision-making purposes. In order to maintain the books of accounts accurately, it is necessary that entities must follow the appropriate basis of accounting. The two primary bases of accounting which are used by the entities are accrual basis of accounting and cash basis accounting. In the realm of financial reporting, the choice of basis of accounting holds substantial significance.

The Institute of Chartered Accountants of India (ICAI) believes that the objectives of preparation of financial statements are best achieved by adoption of the Accounting Standards which are based on accrual basis of accounting. However, laws governing some of the non-company entities allow to follow cash basis of accounting for financial reporting. It has been observed that there is diversity in application of cash basis of accounting.

I am happy that the Accounting Standards Board of ICAI is bringing out the publication 'Technical Guide on *Preparation of Financial Statements under Cash Basis of Accounting'* to provide guidance for preparation of General Purpose Financial Statements by the Entities under the cash basis of accounting. The objective of the Publication is to enhance the consistency and transparency in financial reporting by the non-company entities while following cash basis of accounting and by applying relevant provisions of Accounting Standards.

I appreciate CA. Pramod Jain, Chairman, CA. Abhay Chhajed, Vice-Chairman, and all the members of the Accounting Standards Board for their invaluable contribution in taking this initiative and in the various activities of the Board.

I am sure that the publication would be helpful to all the non-company entities following cash basis of accounting for preparing their financial statements and members of the ICAI in discharging their professional duties.

6th February, 2024

CA. Aniket Sunil Talati
President, ICAI

PREFACE

The Institute of Chartered Accountants of India through Accounting Standards Board (ASB) issues Accounting Standards for preparation of financial statements by non-company entities and for effective implementation of Accounting Standards scheme for applicability of Accounting Standards to non-company entities with certain exemptions and relaxations has also been prescribed.

Accounting standards (AS) are a set of principles which entities follow while preparing their financial statements to provide information about its financial position and financial performance in a relevant, consistent and comparable manner. The financial statements prepared applying Accounting Standards provide true and fair view of the entity's financial position and performance. According to Accounting Standard 1, *Disclosure of Accounting Policies*, 'accrual' is one of the fundamental accounting assumptions. AS 1 also requires disclosure of the fact if any of the fundamental accounting assumption prescribed in the standard is not followed in the preparation and presentation of financial statements.

In accordance with Accounting Standards, the financial reporting can achieve its purpose by following accrual basis of accounting while preparing financial statements. However, the ASB is also aware that laws governing some of these entities allow cash basis of accounting, e.g., Limited Liability Partnership Act 2008 permits LLPs to maintain books of accounts on cash system of accounting. Further, Income Tax Act, 1961, allows all entities having income from business or profession to follow cash system of accounting. The cash basis of accounting is a method of accounting used for simplicity by small entities and individuals. Nonetheless, I am sure that stakeholders appreciate the virtues and acknowledge the limitations of cash basis of accounting.

In order to enhance the quality and relevance of financial statements of non-company entities prepared under cash basis of accounting, the ASB thought appropriate to provide guidance on application of relevant provisions of Accounting Standards while following cash basis of accounting. Therefore, this Technical Guide on *Preparation of Financial Statements under Cash Basis of Accounting* has been issued which is expected to meet the objective of standardising the information to be presented in the financial statements of such entities. I am confident that this Publication will help these entities in complying with the provisions of the Accounting Standards which are relevant in the context of the cash basis of accounting.

I thank and express my gratitude to the Honourable President, CA. Aniket Sunil Talati and Vice-President, CA. Ranjeet Kumar Agarwal, for providing continuous support and encouragement and giving me the opportunity of bringing out this Technical Guide. I am also thankful to Vice Chairman of ASB, CA. Abhay Chhajed, for his support and co-operation in all the activities of the ASB. I also recognise the contribution of all the members of the ASB in various endeavours of the ASB and in finalising this Technical Guide.

I acknowledge the technical and administrative support provided by CA. S.N. Gupta, Joint Director, Technical Directorate, CA. Parminder Kaur, Secretary, ASB and CA. Sonia Minocha, Deputy Secretary, in preparation of this Technical Guide.

I am confident that the Technical Guide would serve as an important guidance for the non-company entities following cash basis of accounting to make their financial statements relevant and meaningful. I am sure that the Technical Guide would also be useful for the auditors of such entities' financial statements and other stakeholders.

New Delhi
February 1, 2024

CA. Pramod Jain
Chairman
Accounting Standards Board

Technical Guide on Preparation of Financial Statements under Cash basis of Accounting

1. Background

1.1 A sound accounting and financial reporting framework acts as an important pillar for promoting accountability of an organisation. The primary objective of financial reporting is to provide information about the entity that is useful to users of general purpose financial statements for decision-making purposes. Financial reporting by an entity about its activities provides useful information about its financial position and financial performance to wide range of users for making decisions about that entity.

1.2 Information about the cash receipts, cash payments and cash balances of an entity is necessary for accountability purposes and to provide inputs useful for assessment of the ability of the entity to generate adequate cash in the future and the likely sources and uses of cash. In making and evaluating decisions about the allocation of cash resources and the sustainability of the entity's activities, users require an understanding of the timing and certainty of cash receipts and cash payments. Apart from information about liquidity position of an entity, cash flows provide reasonable information about solvency of the entity.

2. Objective

2.1 The purpose of this Technical Guide is to provide guidance for preparation of general purpose financial statements of non-company entities under the cash basis of accounting. This includes the application of accounting principles pertaining to recognition, measurement, presentation and disclosure of various items of income and expenses, assets and liabilities in the financial statements in the context of cash basis of accounting.

2.2 Compliance with the requirements of this Technical Guide will enhance the consistency and transparent financial reporting of the cash receipts, cash payments and cash balances of the entity. It will also enhance comparability with the financial statements of other entities which adopt the cash basis of accounting.

3. Basis of Accounting

3.1 The commonly prevailing basis of accounting are:

(a) cash basis of accounting; and
(b) accrual basis of accounting.

3.2 Under the cash basis of accounting, transactions are recorded when the related cash receipts or cash payments take place. Thus, the revenue is recognised when cash is actually received. Similarly, expenses on acquisition and maintenance of assets used for rendering services as well as for employee remuneration and other items are recorded when the related payments are made. The end product of cash basis of accounting is a statement of receipts and payments that classifies cash receipts and cash payments under different heads. It has been observed that some of non-company entities primarily in services sector do follow cash basis of accounting.

3.3 Accrual basis of accounting is the method of recording transactions by which revenue, expenses, assets and liabilities are recognised in the accounts in the period in which they accrue. The accrual basis of accounting includes considerations relating to deferral, allocations, depreciation and amortisation. This basis is also referred to as 'Mercantile Basis/system of Accounting'. Accrual basis of accounting attempts to record the financial effects of the transactions and other events of an entity in the period in which they occur rather than recording them in the period(s) in which cash is received or paid. The goal of accrual basis of accounting is to relate the accomplishments (measured in the form of revenue) and the efforts (measured in terms of costs) so that the reported net income measures an entity's performance during a period rather than merely listing its cash receipts and payments. Apart from income measurement, accrual basis of accounting recognises assets, liabilities or components of revenue and expenses for amounts received or paid in cash in past, and amounts expected to be received or paid in cash in future. Considering the nature of activities performed, it has been observed that entities engaged in manufacturing/trading of goods generally follow accrual basis of accounting.

3.4 In view of above, it can be said that the objectives of financial reporting can best be achieved by adoption of the accrual basis of accounting. Consequently, the Accounting Standards Board (ASB) of the ICAI encourages non-company entities also to prepare financial statements on the accrual basis of accounting. However, the ASB also acknowledges that laws governing some of these entities allow cash basis of accounting or are silent on this aspect, e.g., Limited Liability Partnership Act 2008 permits LLPs to maintain books of accounts on cash system of accounting. Further, sub-section (1) of section 145 of the Income Tax Act, 1961 allows all entities having income from business or profession to follow cash system of accounting. Accordingly, such entities are permitted to maintain their books of accounts under cash basis of accounting.

4. Cash Basis

4.1 Cash Basis of Accounting

4.1.1 The cash basis of accounting recognizes transactions and events only when cash is received or paid by the entity. Financial statements prepared under the cash basis provide readers with information about the sources of cash inflows during the period, the purposes for which cash was used and the cash balances at the reporting date. The measurement focus in the financial statements is cash and bank balances and changes therein. Accordingly, under pure cash basis of accounting, transactions are recorded only when there is actual flow of cash. Revenue is recognised only when it is actually received. Expenditure is recognized only on the outflow of cash. This would result into recognition of cash received or spent during the year even though it may relate to different period. Further, non-cash items, such as, depreciation and impairment losses, do not get recognised since the same do not involve outflow of cash. Considering the information available under cash basis of accounting, i.e., mainly about cash inflows and cash outflows, receipts and payments account can be prepared (please refer paragraph 4.3.3 also).

4.2 Accounting Standards issued by the ICAI for non-company entities

4.2.1 Accounting Standards (AS) which are based on accrual basis of accounting contain wholesome principles of accounting and can be viewed as standardised language of business to communicate high quality information in financial statements based on principles of transparency, consistency, comparability and reliability. Accounting standards are a set of principles which entities follow while preparing the financial statements providing a standardised way of describing the entity's financial position and financial performance. Accounting Standards lay down sound accounting principles under accrual basis of accounting. Accounting Standards apply in respect of any entity engaged in commercial, industrial or business activities. Exclusion of an entity from the applicability of the Accounting Standards is permissible only if no part of the activity of such entity is commercial, industrial or business in nature. Even if where a very small proportion of the activities of an entity were considered to be commercial, industrial or business in nature, the Accounting Standards would apply to all its activities including those, which are not commercial, industrial or business in nature.

4.2.2 The ICAI has formulated 29 Accounting Standards, of which, 27 Accounting Standards are applicable as on date after withdrawal of two Standards i.e. AS 6 on Depreciation and AS 8 on Accounting for Research and Development. The ICAI has also announced the scheme for applicability of Accounting Standards (AS) to non-company entities. In this regard, the criteria for classification of non-company entities as decided by ICAI is given in **Appendix A**. The Accounting Standards issued by the ICAI are also mandatory for the Members of the ICAI in the performance of their attest functions of these entities as per the relevant announcements made by the ICAI from time to time.

4.3 Compliance with Accounting Standards while following cash basis of accounting

4.3.1 With regard to the application of Accounting Standards, following paragraph of the Announcement of the ICAI may be noted:

Announcement: *Mandatory Application of Accounting Standards in respect of Certain Non-corporate Bodies*:

"…

3. According to Accounting Standard 1, Disclosure of Accounting Policies, 'accrual' is one of the fundamental accounting assumptions. The Standard requires that if any fundamental accounting assumption is not followed in the preparation and presentation of financial statements, the fact should be disclosed. Accordingly, in respect of individual/bodies covered by para 1 above, the auditor should examine whether the financial statements have been prepared on accrual basis. In cases where the statute governing the enterprise requires the preparation and presentation of financial statements on accrual basis but the financial statements have not been so prepared, the auditor should qualify his report. On the other hand, where there is no statutory requirement for preparation and presentation of financial statements on accrual basis, and the financial statements have been prepared on a basis other than 'accrual' the auditor should describe in his audit report, the basis of accounting followed, without necessarily making it a subject matter of a qualification. In such a case the auditor should also examine whether those provisions of the accounting standards which are applicable in the context of the basis of accounting followed by the enterprise have been complied with or not and consider making suitable disclosures/qualifications in his audit report accordingly."

Please refer **Appendix B** for the complete Announcement**.**

4.3.2 In view of the above, entities while following cash basis of accounting shall follow Accounting Standards as and when and to the extent these are applicable to them.

4.3.3 *Framework for Preparation and Presentation of Financial Statements* issued by the ICAI deals with recognition and measurement of elements of financial statements i.e., income, expenses, assets, liabilities and equity. The Accounting Standards deal with recognition, measurement, presentation and disclosures of these elements in more detailed manner.

Requirements of Accounting Standards applicable in the context of cash basis of accounting, can be understood as recognising elements of financial statements on receipt and payment basis subject to meeting definitions of the relevant items and meeting the relevant recognition criteria under Framework and the Accounting Standards. The measurement of elements of financial statements similar to cash basis of accounting would be at the amount of cash paid or received. For example, if recognition criteria for recognising an item as Property, plant and equipment as laid down under AS 10 is met, however, cash for asset is not paid instead other cost attributable to asset, such as, installation expenses, have been paid in cash, then asset shall be recognised when cash outflows take place and the measurement shall be at amount of cash paid for installation expenses. Accordingly, for recognition and measurement of elements of financial statements under cash basis of accounting, predominant consideration will be of cash flows. Further, the presentation and disclosures of items of income, expenses, assets, liabilities and equity shall be in accordance with the Accounting Standards to the extent relevant under cash basis of accounting. Some of the instances of disclosures relevant while following cash basis of accounting and applying relevant provisions of Accounting Standards have been discussed in the subsequent section.

Recognition and measurement of all the elements of financial statements under pure cash basis of accounting would provide information about cash received or spent during the year even though it may relate to different period. In other words, considering the information available under pure cash basis of accounting, i.e., mainly about cash inflows and cash outflows, receipts and payments account can be prepared. While it will provide some relevant information but may not meet all the information needs of the stakeholders. Therefore, such entities also prepare income and expenditure account and the balance sheet and recognise non-cash items also, for example, depreciation, impairment of assets, write down of inventories, bad-debts, etc. Implementing pure cash basis of accounting as discussed in paragraph 4.1.1, these non-cash items may not get recognised, however, to make the information relevant, to the extent possible, these non-cash items are also required to be recognised in the financial statements. This results into presentation of fair picture of the financial affairs of the entity. Moreover, some of such items are recognised under Income Tax Laws also. In other words, these non-cash expenses are expenses that are recognised in an income statement even though the same do not involve cash outflows. These transactions are typically accounting entries made to reflect economic events that affect the entity's financial position and performance.

4.3.4 Accounting of some of the items of income, expenses, assets and liabilities following cash basis of accounting and applying relevant provisions of Framework and Accounting Standards as and when and to the extent possible have been discussed hereinafter. Further, recognition and disclosure of certain non-cash items while following cash system of accounting and applying Accounting Standards are also discussed hereinafter.

1. Income

(i) As per the Framework for the preparation and presentation of Financial Statements, income is increase in economic benefits during the accounting period when that increase results either in the form of inflows or enhancements of assets or in the form of decreases in liabilities. The definition of income encompasses both revenue and gains.

In accordance with AS 9, *Revenue Recognition*, revenue is recognised when risks and rewards have been transferred and there is no uncertainties exit regarding amount of consideration. AS 9 prescribes accounting for revenue from sales and services, interest, royalties, rental on investments and dividends. While following cash basis of accounting, revenue shall be recognised when cash has been received. Further, interest, royalties, rental on investments and dividends shall also be recognised on receipt basis. In case, revenue has not been received in cash, however, tax has been deducted and deposited by the payer, in that case, revenue shall be recognised equivalent to the amount of tax deducted at source. The relevant disclosures in this regard shall be provided.

(ii) Government grants are assistance by government in cash or in kind to an entity for past or future compliance with certain conditions. Under accrual basis of accounting, government grants are to be recognised as per AS 12, *Accounting for Government Grants* when there is reasonable assurance that (i) the entity will comply with the conditions attached to them, and (ii) the grants will be received. In accordance with AS 12, grants shall be classified as grants related to revenue, grants related to specific assets, grants in the nature of promoters' contribution and non-monetary grants. Under cash basis of accounting, grant shall be recognised when it has been received. The disclosure regarding nature of grants recognised in the financial statements, including non-monetary grants given at a concessional rate or free of cost shall be provided.

2. Expenses

(iii) As per the Framework for the preparation and presentation of Financial Statements, the definition of 'expense' encompasses both, expenses that arise in the course of the ordinary activities of entities as well as losses. Losses represent other items that meet the definition of 'expense' and may or may not arise in the course of the ordinary activities of entities. Under accrual basis of accounting, expenses are recognised when it is probable that the consumption or loss of future economic benefits results in a reduction in assets and/or an increase in liabilities and the consumption or loss of future economic benefits can be measured reliably. Under cash basis of accounting, expenses are recognised as and when paid.

(iv) Salaries and other employee benefits expenses are recognised in accordance with AS 15, *Employee Benefits*, which prescribes the accounting and disclosure for all employee benefits, except employee share-based payments. In accordance with AS 15, employee benefits expenses are recognised when employee has rendered the services to the entity. In accordance with AS 15, employee benefits expenses are classified as short-term employee benefits, post-employment benefits, long-term employee benefits and termination benefits. Under cash basis of accounting, employee benefits are recognised as and when paid. The information that enables users of financial statements to evaluate the nature of employee benefit expenses shall be disclosed.

(v) In accordance with AS 16, *Borrowing Costs, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are* *capitalised as part of the cost of a qualifying asset, i.e., when it is probable that they will result in future economic benefits to the enterprise and the costs can be measured reliably. Other borrowing costs are recognised as an expense in the period in which they are incurred.* Under cash basis of accounting, borrowing costs shall be capitalised or expensed in the period in which they are paid. Capitalisation of borrowing costs shall commence when expenditure for the acquisition, construction or production of a qualifying asset is paid and all the activities necessary to prepare the qualifying asset for its intended use or sale are in progress. Borrowing costs paid after substantial completion of all the activities necessary to prepare the qualifying asset for its intended use or sale shall be expensed off. The disclosure shall be provided regarding accounting policy adopted for borrowing costs; and the amount of borrowing costs capitalised during the period.

(vi) AS 19, *Leases*, prescribes the accounting treatment, for lessees and lessors, in relation to finance and operating leases. In accordance with AS 19, under accrual basis of accounting, leases are classified as finance lease and operating lease on the basis of transfer of risks and rewards incidental to ownership. Under cash basis of accounting, lease payments under both operating and finance lease shall be recognised as per AS 19 when paid.

(vii) AS 11 deals with accounting for foreign currency transactions and foreign operations. It provides guidance to decide which exchange rate to use and how to recognise in the financial statements the financial effect of changes in exchange. While following cash basis of accounting, foreign currency transaction shall be accounted for in the reporting currency by applying to the foreign currency amount, exchange rate between the reporting currency and the foreign currency at the date of receipts and payments. Losses or gains arising due to exchange rate variation on derecognition of monetary assets or liabilities recognised under cash basis of accounting, such as, foreign currency borrowings, shall be recognised as loss or gain. Cash and Bank balances in foreign currency shall be restated in accordance with AS 11, *The Effects of Changes in Foreign Exchange Rates*.

The entities shall disclose the amount of exchange differences included in the net profit or loss for the period.

(viii) **Non-cash expenses: Depreciation and Impairment -** Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life. In accordance with the requirements of AS 10, *Property, Plant and Equipment,* each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately. Similarly, AS 28, *Impairment of Assets*, requires asset to be impaired in case recoverable amount of an asset is less that its carrying amount. As mentioned above in paragraph 4.3.3, while following cash basis of accounting, entities shall also recognise depreciation and impairment of assets as expense in profit and loss account so that the periodic net result of operations of the entity reflects the use of the asset. Similarly, difference arising on valuation of inventories at lower of cost and net realisable value, shall also be recognised in the profit or loss account. (refer paragraph 4 (xii) below).

(ix) **Tax paid and Tax Refund –** The tax paid for the financial year shall be recognised as expense in the profit and loss. In case, entity has paid the tax more than the current tax for the financial year, and the entity is reasonably certain that the additional tax paid will be received as tax refund, then it shall expense off the amount in the profit or loss to the extent of actual current tax and recognise the balance amount as 'tax refund receivable' in the balance sheet.

3. Liabilities

(x) Under cash basis of accounting, liabilities for borrowings shall be recognised when cash is received and considered as discharged when such borrowings/liabilities are paid. Borrowing costs shall be recognized as per AS 16 as discussed in paragraph 2(v) above.

4. Assets

(xi) As per the Framework for the preparation and presentation of Financial Statements, an asset is a resource controlled by an entity as a result of past events and from which future economic benefits are expected to flow to the entity. An asset should be recognised in the balance sheet when it is probable that the future economic benefits embodied in the asset will flow to the entity to achieve its objectives; and the asset possesses a cost or value that can be measured reliably. Under cash basis of accounting assets are recognised as and when recognition criteria laid down in this regard is met and cash to obtain the asset has been paid.

(xii) As per AS 2, *Valuation of Inventories*, inventories should be recognised when it meets the definition and should be measured at lower of cost and net realisable value. The net realisable value is the estimated selling price in the ordinary course of business less the estimated cost of completion and the estimated cost necessary to make the sale. Entities engaged in manufacturing/trading of goods while following cash basis of accounting, shall value inventories at lower of cost and net realisable value and recognise difference between the two in the profit or loss account. The entity shall disclose the accounting policies adopted in measuring inventories, including the cost formula used and the total carrying amount of inventories and its classification.

(xiii) In accordance with AS 10, *Property, Plant and Equipment,* an asset shall be classified as property, plant and equipment (PPE) if it is held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and is expected to be used during more than a period of twelve months. Under accrual basis of accounting, as per AS 10, PPE are recognised when it is probable that future economic benefits associated with item of PPE will flow to the entity and the cost of the asset can be measured reliably. Further, recognition of costs in the carrying amount of an item of property, plant and equipment ceases when the item is in the location and condition necessary for it to be capable of operating in the manner intended by management. While following cash basis of accounting, the entity shall recognise an item of PPE when recognition criteria as per AS 10 is met and the cost of the asset has been paid. Cost paid after the asset is in the location and condition necessary for it to be capable of operating in the manner intended by the management, shall be expensed off.

Similarly, in accordance with AS 26, *Intangible Asset*, intangible asset are recognised when it meets the definition of an intangible asset and it is probable that future economic benefits associated with such asset will flow to the entity and the cost of the asset can be measured reliably. Intangible asset is defined as an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. While following cash basis of accounting, the entity shall recognise an intangible asset if it meets the recognition criteria as per AS 26 and when the cost of the intangible asset has been paid.

(xiv) Loans and advances to the employees and others shall be accounted for under cash basis of accounting as and when cash is actually disbursed.

5. Others

(xv) AS 1, *Disclosure of Accounting Policies*, principally requires the disclosure of significant accounting policies and specifies the manner of their disclosure. A statement of significant accounting policies followed in the preparation and presentation of financial statements is necessary. Further, all significant accounting policies should be disclosed at one place. Accordingly, significant accounting policies followed in preparation of financial statements while following cash basis of accounting should be disclosed at one place. AS 1 also requires disclosure if fundamental accounting assumptions, i.e., *Going Concern, Consistency and Accrual* are not followed. While following cash basis of accounting, a disclosure in this regard should be made.

(xvi) For non-company entities, AS 3, *Cash Flow Statements*, provides that financial statements of Micro, Small and Medium Sized Enterprises (Level IV, Level III and Level II non-company entities), may not include cash flow statements, i.e., preparation of cash flow statement is not mandatory. Accordingly, Level I non-company entities following cash basis of accounting, shall prepare cash flow statement.

(xvii) Prior Period Adjustments – In accordance with AS 5, prior period items are income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods. Prior period items are normally included in the determination of net profit or loss for the current period. An alternative approach is to show such items in the statement of profit and loss after determination of current net profit or loss. In either case, the objective is to indicate the effect of such items on the current profit or loss. While following cash basis of accounting, prior period adjustments shall be presented and disclosed separately. For example, if cost incurred for items of property, plant and equipment was erroneously recognised as repair and maintenance in profit or loss account during an earlier year, then such error shall be rectified in the subsequent year by reversing it as property, plant and equipment.

(xviii) Entities that are operating in different geographical locations or are involved in different kinds of service delivery programmes/projects which meet the definitions of 'geographical segment' and 'business segment', should disclose segmental information in accordance with AS 17, *Segment Reporting*, to the extent possible under cash basis of accounting.

It may be noted that AS 17 is not mandatory for Micro, Small and Medium Entities (Level IV, Level III and Level II non-company entities).

(xix) AS 18, *Related Party Disclosures* establishes the requirements for disclosure of related party relationships, and transactions between a reporting entity and its related parties. Without the related party disclosures, there is a general presumption that transactions reflected in financial statements are consummated on an arm's-length basis between independent parties. Disclosing transactions between related parties enhances transparency, accountability, and fairness. Some of the examples of related party transactions are as follows:

(a) sale, purchase, and transfer of property;
(b) services received or provided;
(c) interest on loan
(d) borrowing or lending, including guarantees; and
(e) receipt of salary, honorarium or any other monetary or non-monetary benefits.

Disclosures as per AS 18 shall be in line with the recognition and measurement of such items in the financial statements as per cash basis of accounting.

It may be noted that AS 18 is not mandatory for Micro and Small Entities (Level IV and Level III non-company entities).

(xx) While following cash basis of accounting, AS 22, *Accounting for Taxes on Income*, shall be applicable to non-company entities for Current tax requirements.

5. Books of Account To Be Maintained

5.1 Every entity should maintain proper books of account with respect to:

(a) all sums of monies received and the matters in respect of which receipts took place, showing distinctly the amounts received from income generating activities and through grants and donations;

(b) all sums of money expended and the matters in respect of which expenditure is incurred;

(c) all assets and liabilities.

6. Formats of Financial Statements

6.1 The accounting process in an organisation culminates in the preparation of its financial statements. Financial statements are intended to reflect the operating results during a given period and the state of affairs at a particular date in a clear and comprehensive manner. The basic financial statements relevant to non-company entities are balance sheet, statement of profit and loss and notes, other statements and explanatory material that are an integral part of the financial statements. They may also include supplementary schedules and information based on or derived from, and expected to be read with such statements. Financial Statements also include cash flow statement. Please refer paragraph 4.3.3 (5) (xvi) above for preparation of cash flow statement for non-company entities.

6.2 The ASB of ICAI has prescribed the Formats of Financial Statements for Non-Corporate Entities and Limited Liability Partnerships separately through Guidance Notes and for NPOs through Technical Guide. The entities following cash basis of accounting are encouraged to follow the formats prescribed to the extent applicable.

Appendix A

Announcement

Criteria for classification of Non-company entities for applicability of Accounting Standards

The Council, at its 400th meeting, held on March 18-19, 2021, considered the matter relating to applicability of Accounting Standards issued by The Institute of Chartered Accountants of India (ICAI), to Non-company entities (Enterprises). The scheme for applicability of Accounting Standards to Non-company entities shall come into effect in respect of accounting periods commencing on or after April 1, 2020.

1. For the purpose of applicability of Accounting Standards, Non-company entities are classified into four categories, viz., Level I, Level II, Level III and Level IV.

   Level I entities are large size entities, Level II entities are medium size entities, Level III entities are small size entities and Level IV entities are micro entities. Level IV, Level III and Level II entities are referred to as Micro, Small and Medium size entities (MSMEs). The criteria for classification of Non-company entities into different levels are given in Annexure 1.

   The terms 'Small and Medium Enterprise' and 'SME' used in Accounting Standards shall be read as 'Micro, Small and Medium size entity' and 'MSME' respectively.

2. Level I entities are required to comply in full with all the Accounting Standards.

3. Certain exemptions/relaxations have been provided to Level II, Level III and Level IV Non-company entities. Applicability of Accounting Standards and exemptions/relaxations to such entities are given in Annexure 2.

4. This Announcement supersedes the earlier Announcement of the ICAI on '**Harmonisation of various differences between the Accounting Standards issued by the ICAI and the Accounting Standards notified by the Central Government'** issued in February 2008, to the extent it prescribes the criteria for classification of Non-company entities (Non-corporate entities) and applicability of Accounting Standards to non-company entities, and the Announcement '**Revision in the criteria for classifying Level II non-corporate entities**' issued in January

2013.

5. This Announcement is not relevant for Non-company entities who may be required to follow Ind AS as per relevant regulatory requirements applicable to such entities.

6. The changes arising from this Announcement will be incorporated in the Accounting Standards while publishing the updated Compendium of Accounting Standards.

Annexure 1

Criteria for classification of Non-company Entities as decided by the Institute of Chartered Accountants of India

Level I Entities

Non-company entities which fall in any one or more of the following categories, at the end of the relevant accounting period, are classified as Level I entities:

(i) Entities whose securities are listed or are in the process of listing on any stock exchange, whether in India or outside India.

(ii) Banks (including co-operative banks), financial institutions or entities carrying on insurance business.

(iii) All entities engaged in commercial, industrial or business activities, whose turnover (excluding other income) exceeds rupees two-fifty crore in the immediately preceding accounting year.

(iv) All entities engaged in commercial, industrial or business activities having borrowings (including public deposits) in excess of rupees fifty crore at any time during the immediately preceding accounting year.

(v) Holding and subsidiary entities of any one of the above.

Level II Entities

Non-company entities which are not Level I entities but fall in any one or more of the following categories are classified as Level II entities:

(i) All entities engaged in commercial, industrial or business activities, whose turnover (excluding other income) exceeds rupees fifty crore but does not exceed rupees two-fifty crore in the immediately preceding accounting year.

(ii) All entities engaged in commercial, industrial or business activities having borrowings (including public deposits) in excess of rupees ten crore but not in excess of rupees fifty crore at any time during the immediately preceding accounting year.

(iii) Holding and subsidiary entities of any one of the above.

Level III Entities

Non-company entities which are not covered under Level I and Level II but fall in any one or more of the following categories are classified as Level III entities:

(i) All entities engaged in commercial, industrial or business activities, whose turnover (excluding other income) exceeds rupees ten crore but does not exceed rupees fifty crore in the immediately preceding accounting year.

(ii) All entities engaged in commercial, industrial or business activities having borrowings (including public deposits) in excess of rupees two crore but does not exceed rupees ten crore at any time during the immediately preceding accounting year.

(iii) Holding and subsidiary entities of any one of the above.

Level IV Entities

Non-company entities which are not covered under Level I, Level II and Level III are considered as Level IV entities.

Additional requirements

(1) An MSME which avails the exemptions or relaxations given to it shall disclose (by way of a note to its financial statements) the fact that it is an MSME, the Level of MSME and that it has complied with the Accounting Standards insofar as they are applicable to entities falling in Level II or Level III or Level IV, as the case may be.

(2) Where an entity, being covered in Level II or Level III or Level IV, had qualified for any exemption or relaxation previously but no longer qualifies for the relevant exemption or relaxation in the current accounting period, the relevant standards or requirements become applicable from the current period and the figures for the corresponding period of the previous accounting period need not be revised merely by reason of its having ceased to be covered in Level II or Level III or Level IV, as the case may be. The fact that the entity was covered in Level II or Level III or Level IV, as the case may be, in the previous period and it had availed of the exemptions or relaxations available to that Level of entities shall be disclosed in the notes to the financial statements. The fact that previous period figures have not been revised shall also be disclosed in the notes to the financial statements.

(3) Where an entity has been covered in Level I and subsequently, ceases to be so covered and gets covered in Level II or Level III or Level IV, the entity will not qualify for exemption/relaxation available to that Level, until the entity ceases to be covered in Level I for two consecutive years. Similar is the case in respect of an entity, which has been covered in Level II or Level III and subsequently, gets covered under Level III or Level IV.

(4) If an entity covered in Level II or Level III or Level IV opts not to avail of the exemptions or relaxations available to that Level of entities in respect of any but not all of the Accounting Standards, it shall disclose the Standard(s) in respect of which

it has availed the exemption or relaxation.

(5) If an entity covered in Level II or Level III or Level IV opts not to avail any one or more of the exemptions or relaxations available to that Level of entities, it shall comply with the relevant requirements of the Accounting Standard.

(6) An entity covered in Level II or Level III or Level IV may opt for availing certain exemptions or relaxations from compliance with the requirements prescribed in an Accounting Standard:

Provided that such a partial exemption or relaxation and disclosure shall not be permitted to mislead any person or public.

(7) In respect of Accounting Standard (AS) 15, *Employee Benefits*, exemptions/ relaxations are available to Level II and Level III entities, under two sub-classifications, viz., (i) entities whose average number of persons employed during the year is 50 or more, and (ii) entities whose average number of persons employed during the year is less than 50. The requirements stated in paragraphs (1) to (6) above, mutatis mutandis, apply to these sub-classifications.

Annexure 2

Applicability of Accounting Standards to Non-company Entities

The Accounting Standards issued by the ICAI, as on April 1, 2020, and such standards as issued from time-to-time are applicable to Non-company entities subject to the relaxations and exemptions in the announcement. The Accounting Standards issued by ICAI as on April 1, 2020, are:

AS 1	Disclosure of Accounting Policies
AS 2	Valuation of Inventories
AS 3	Cash Flow Statements
AS 4	Contingencies and Events Occurring After the Balance Sheet Date
AS 5	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies
AS 7	Construction Contracts
AS 9	Revenue Recognition
AS 10	Property, Plant and Equipment
AS 11	The Effects of Changes in Foreign Exchange Rates
AS 12	Accounting for Government Grants
AS 13	Accounting for Investments
AS 14	Accounting for Amalgamations
AS 15	Employee Benefits
AS 16	Borrowing Costs
AS 17	Segment Reporting
AS 18	Related Party Disclosures
AS 19	Leases

AS 20	Earnings Per Share
AS 21	Consolidated Financial Statements
AS 22	Accounting for Taxes on Income
AS 23	Accounting for Investments in Associates in Consolidated Financial Statements
AS 24	Discontinuing Operations
AS 25	Interim Financial Reporting
AS 26	Intangible Assets
AS 27	Financial Reporting of Interests in Joint Ventures
AS 28	Impairment of Assets
AS 29	Provisions, Contingent Liabilities and Contingent Assets

(1) Applicability of the Accounting Standards to Level 1 Non- company entities.

Level I entities are required to comply in full with all the Accounting Standards.

(2) Applicability of the Accounting Standards and exemptions/relaxations for Level II, Level III and Level IV Non-company entities

***(A) Accounting* Standards applicable to Non-company entities**

AS	**Level II Entities**	**Level III Entities**	**Level IV Entities**
AS 1	Applicable	Applicable	Applicable
AS 2	Applicable	Applicable	Applicable
AS 3	Not Applicable	Not Applicable	Not Applicable
AS 4	Applicable	Applicable	Applicable
AS 5	Applicable	Applicable	Applicable
AS 7	Applicable	Applicable	Applicable
AS 9	Applicable	Applicable	Applicable
AS 10	Applicable	Applicable with	Applicable with

		disclosures exemption	disclosures exemption
AS 11	Applicable	Applicable with disclosures exemption	Applicable with disclosures exemption
AS 12	Applicable	Applicable	Applicable
AS 13	Applicable	Applicable	Applicable
AS 14	Applicable	Applicable	Not Applicable (Refer note 2(C))
AS 15	Applicable with exemptions	Applicable with exemptions	Applicable with exemptions
AS 16	Applicable	Applicable	Applicable
AS 17	Not Applicable	Not Applicable	Not Applicable
AS 18	Applicable	Not Applicable	Not Applicable
AS 19	Applicable with disclosures exemption	Applicable with disclosures exemption	Applicable with disclosures exemption
AS 20	**Not Applicable**	**Not Applicable**	Not Applicable
AS 21	Not Applicable (Refer note 2(D))	Not Applicable (Refer note 2(D))	Not Applicable (Refer note 2(D))
AS 22	Applicable	Applicable	Applicable only for current tax related provisions (Refer note 2(B)(vi))
AS 23	**Not Applicable (Refer note 2(D))**	**Not Applicable (Refer note 2(D))**	Not Applicable (Refer note 2(D))
AS 24	Applicable	Not Applicable	Not Applicable
AS 25	Not Applicable (Refer note 2(D))	Not Applicable (Refer note 2(D))	Not Applicable (Refer note 2(D))
AS 26	Applicable	Applicable	Applicable with disclosures exemption

AS 27	**Not Applicable (Refer notes 2(C) and 2(D))**	**Not Applicable (Refer notes 2(C) and 2(D))**	Not Applicable (Refer notes 2(C) and 2(D))
AS 28	Applicable with disclosures exemption	Applicable with disclosures exemption	Not Applicable
AS 29	Applicable with disclosures exemption	Applicable with disclosures exemption	Applicable with disclosures exemption

(B) Accounting Standards in respect of which relaxations/exemptions from certain requirements have been given to Level II, Level III and Level IV Non-company entities[1]:

(i) Accounting Standard (AS) 10, Property, Plant and Equipment

Paragraph 87 relating to encouraged disclosures is not applicable to Level III and Level IV Non-company entities.

(ii) AS 11, The Effects of Changes in Foreign Exchange Rates (revised 2018)

Paragraph 44 relating to encouraged disclosures is not applicable to Level III and Level IV Non-company entities.

(iii) Accounting Standard (AS) 15, Employee Benefits (revised 2005)

(1) Level II and Level III Non-company entities whose average number of persons employed during the year is 50 or more are exempted from the applicability of the following paragraphs:

(a) paragraphs 11 to 16 of the standard to the extent they deal with recognition and measurement of short-term accumulating compensated absences which are non-vesting (i.e., short-term accumulating compensated absences in respect of which employees are not entitled to cash payment for unused entitlement on leaving);

(b) paragraphs 46 and 139 of the Standard which deal with discounting of amounts that fall due more than 12 months after the balance sheet date;

[1] Level IV non-company entities were given exemption regarding disclosure under paragraph 35(f) of AS 13 related to disclosure specifically required by relevant statue governing the enterprise. The Council at its 427th meeting held on January 3-4, 2024, decided not to exempt the aforesaid disclosure requirement.

(c) recognition and measurement principles laid down in paragraphs 50 to 116 and presentation and disclosure requirements laid down in paragraphs 117 to 123 of the Standard in respect of accounting for defined benefit plans. However, such entities should actuarially determine and provide for the accrued liability in respect of defined benefit plans by using the Projected Unit Credit Method and the discount rate used should be determined by reference to market yields at the balance sheet date on government bonds as per paragraph 78 of the Standard. Such entities should disclose actuarial assumptions as per paragraph 120(l) of the Standard; and

(d) recognition and measurement principles laid down in paragraphs 129 to 131 of the Standard in respect of accounting for other long-term employee benefits. However, such entities should actuarially determine and provide for the accrued liability in respect of other long-term employee benefits by using the Projected Unit Credit Method and the discount rate used should be determined by reference to market yields at the balance sheet date on government bonds as per paragraph 78 of the Standard.

(2) Level II and Level III Non-company entities whose average number of persons employed during the year is less than 50 and Level IV Non-company entities irrespective of number of employees are exempted from the applicability of the following paragraphs:

(a) paragraphs 11 to 16 of the standard to the extent they deal with recognition and measurement of short-term accumulating compensated absences which are non-vesting (i.e., short-term accumulating compensated absences in respect of which employees are not entitled to cash payment for unused entitlement on leaving);

(b) paragraphs 46 and 139 of the Standard which deal with discounting of amounts that fall due more than 12 months after the balance sheet date;

(c) recognition and measurement principles laid down in paragraphs 50 to 116 and presentation and disclosure requirements laid down in paragraphs 117 to 123 of the Standard in respect of accounting for defined benefit plans. However, such entities may calculate and account for the accrued liability under the defined benefit plans by reference to some other rational method, e.g., a method based on the assumption that such benefits are payable to all employees at the end of the accounting year; and

(d) recognition and measurement principles laid down in paragraphs 129 to 131 of the Standard in respect of accounting for other long-term employee benefits. Such entities may calculate and account for the accrued liability under the other long-term employee benefits by reference to some other rational method, e.g., a method based on the assumption that such benefits are payable to all employees at the end of the accounting year.

(iv) AS 19, Leases

(a) Paragraphs 22 (c), (e) and (f); 25 (a), (b) and (e); 37 (a) and (f); and 46 (b) and (d) relating to disclosures are not applicable to Level II Non-company entities.

(b) Paragraphs 22 (c), (e) and (f); 25 (a), (b) and (e); 37 (a), (f) and (g); and 46 (b), (d) and (e) relating to disclosures are not applicable to Level III Non-company entities.

(c) Paragraphs 22 (c), (e) and (f); 25 (a), (b) and (e); 37 (a), (f) and (g); 38; and 46 (b), (d) and (e) relating to disclosures are not applicable to Level IV Non-company entities.

(v) AS 22, Accounting for Taxes on Income

(a) Level IV Non-company entities shall apply the requirements of AS 22, Accounting for Taxes on Income, for Current tax defined in paragraph 4.4 of AS 22, with recognition as per paragraph 9, measurement as per paragraph 20 of AS 22, and presentation and disclosure as per paragraphs 27-28 of AS 22.

(b) Transitional requirements

On the first occasion when a Non-company entity gets classified as Level IV entity, the accumulated deferred tax asset/liability appearing in the financial statements of immediate previous accounting period, shall be adjusted against the opening revenue reserves.

(vi) AS 26, Intangible Assets

Paragraphs 90(d)(iii); 90(d)(iv) and 98 relating to disclosures are not applicable to Level IV Non-company entities.

(vii) AS 28, Impairment of Assets

(a) Level II and Level III Non-company entities are allowed to measure the 'value in use' on the basis of reasonable estimate thereof instead of computing the value in use by present value technique. Consequently, if Level II or Level III Non-company entity chooses to measure the 'value in use' by not using the present value technique, the relevant provisions of AS 28, such as discount rate etc., would not be applicable to such an entity. Further, such an entity need not disclose the information required by paragraph 121(g) of the Standard.

(b) Also, paragraphs 121(c)(ii); 121(d)(i); 121(d)(ii) and 123 relating to disclosures are not applicable to Level III Non-company entities.

(viii) AS 29, Provisions, Contingent Liabilities and Contingent Assets (revised 2016)

Paragraphs 66 and 67 relating to disclosures are not applicable to Level II, Level III and Level IV Non-company entities.

(C) In case of Level IV Non-company entities, generally there are no such transactions that are covered under AS 14, *Accounting for Amalgamations*, or jointly controlled operations or jointly controlled assets covered under AS 27, *Financial Reporting of Interests in Joint Ventures*. Therefore, these standards are not applicable to Level IV Non-company entities. However, if there are any such transactions, these entities shall apply the requirements of the relevant standard.

(D) AS 21, *Consolidated Financial Statements,* AS 23, *Accounting for Investments in Associates in Consolidated Financial Statements*, AS 27, *Financial Reporting of Interests in Joint Ventures* (to the extent of requirements relating to Consolidated Financial Statements), and AS 25, *Interim Financial Reporting*, do not require a Non-company entity to present consolidated financial statements and interim financial report, respectively. Relevant AS is applicable only if a Non-company entity is required or elects to prepare and present consolidated financial statements or interim financial report.

Appendix B
Announcement

Mandatory Application of Accounting Standards in respect of Certain Non-corporate Bodies[2]

1. In May 1991 issue of 'The Chartered Accountant', an announcement was carried regarding the decision of the Council of the Institute of Chartered Accountants of India to defer the mandatory application of Accounting Standards 1, 7, 8, 9, 10 and 11 to accounts for periods beginning on or after 1.4.1993, in respect of the following:

(a) Sole proprietary concerns/individuals

(b) Partnership firms

(c) Societies registered under the Societies Registration Act

(d) Trusts

(e) Hindu Undivided Families

(f) Associations of persons.

2. The matter was re-considered by the Council at its meeting held in September, 1993 and it was decided, in partial modification of the earlier decision, that the aforesaid Accounting Standards (except Accounting Standard 11, which has already been withdrawn), shall mandatorily apply in respect of general purpose financial statements of the individual/bodies listed at (a) - (f) above for periods beginning on or after 1.4.1993, where such statements are statutorily required to be audited under any law. It may be reiterated that the Institute issues Accounting Standards for use in the presentation of

[2] Published in 'The Chartered Accountant', January, 1994 (page 639). For auditor's duties in relation to mandatory accounting standards, reference may be made to the Announcement concerning mandatory accounting standards published in the July, 1990 issue of the Journal (See Announcement II). Further, in this regard, the Council issued an Announcement on applicability of accounting standards in the context of section 44AB of the Income Tax Act (See Announcement VI). Also, subsequently, an Announcement on applicability of accounting standards to Charitable and/or Religious Organisations was issued (See Announcement VIII). Further, a Clarification, namely, General Clarification (GC)- 12/2002 on applicability of accounting standards to Co-operative Societies was issued (See Announcement XVI). It may be noted that with the issuance of the Preface to the Statements of Accounting Standards (revised 2004), the Announcement on 'Applicability of Accounting Standards to Charitable and/or Religious Organisations' and GC-12/2002 stand superseded. The revised Preface is published elsewhere in this Compendium.

general purpose financial statements issued to the public by such commercial, industrial or business enterprises as may be specified by the Institute from time to time and subject to the attest function of its members. The term “General Purpose Financial Statements” includes balance sheet, statement of profit and loss and other statements and explanatory notes which form part thereof, issued for use of shareholders/members, creditors, employees and public at large.

3. According to Accounting Standard 1, Disclosure of Accounting Policies, ‘accrual’ is one of the fundamental accounting assumptions. The Standard requires that if any fundamental accounting assumption is not followed in the preparation and presentation of financial statements, the fact should be disclosed. Accordingly, in respect of individual/bodies covered by para 1 above, the auditor should examine whether the financial statements have been prepared on accrual basis. In cases where the statute governing the enterprise requires the preparation and presentation of financial statements on accrual basis but the financial statements have not been so prepared, the auditor should qualify his report. On the other hand, where there is no *statutory requirement* for preparation and presentation of financial statements on accrual basis, and the financial statements have been prepared on a basis other than ‘accrual’ the auditor should describe in his audit report, the basis of accounting followed, without necessarily making it a subject matter of a qualification. In such a case the auditor should also examine whether those provisions of the accounting standards which are applicable in the context of the basis of accounting followed by the enterprise have been complied with or not and consider making suitable disclosures/ qualifications in his audit report accordingly.

4. An example of a disclosure in the audit report of an enterprise which follows cash basis of accounting is given below:

> “It is the policy of the enterprise to prepare its financial statements on the cash receipts and disbursements basis. On this basis revenue and the related assets are recognised when received rather than when earned, and expenses are recognised when paid rather than when the obligation is incurred.
>
> In our opinion, the financial statements give a true and fair view of the assets and liabilities arising from cash transactions of ..... at ...... and of the revenue collected and expenses paid during the year then ended on the cash receipts and disbursements basis as described in Note X.”

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