IFRS Notes

ICAI revises ITFG bulletin 5 and issues FAQ on treatment of securities premium account on transition to Ind AS

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Background

With Ind AS being applicable to large corporates from 1 April 2016, the Institute of Chartered Accountants of India (ICAI), on 11 January 2016 announced the formation of the Ind AS Transition Facilitation Group (ITFG) in order to provide clarifications on issues arising due to applicability and/or implementation of Ind AS under the Companies (Indian Accounting Standards) Rules, 2015 (Rules 2015).

Over the past year, ITFG issued seven bulletins to provide guidance on issues relating to the application of Ind AS.

New development

The Ind AS Transition Facilitation Group (ITFG) held its eighth and ninth meetings on 1 April and 8 April 2017, respectively. In these meetings, the ITFG reconsidered certain issues that were part of ITFG Clarification Bulletin 5 (bulletin 5), on the basis of the representations received from the stakeholders. Accordingly, on 17 April 2017, the ITFG issued a revised Clarification Bulletin 5 (revised bulletin 5), wherein they withdrew Issue No. 2 (clarification on current and non-current classification of security deposits) and revised Issues No. 4 and 5 (pertaining to the deemed cost exemption for property, plant and equipment).

In addition, on 17 April 2017, the ICAI issued a frequently asked question (FAQ) on treatment of the securities premium account under Ind AS on date of transition. This FAQ replaces Issue No. 7 of the ITFG Bulletin 2 that was previously released in May 2016.

This issue of IFRS Notes provides an overview of clarifications provided by ICAI.

Overview of clarifications provided by ICAI

Revisions to ITFG Bulletin 5

The ITFG has revised its responses to the following Ind AS application issues through its revised bulletin 5.

1) Issue No. 2: Guidance on current and non-current classification

In bulletin 5, the ITFG considered a situation wherein an electricity distribution company collected security deposits at the time of issue of electricity connection, which was refundable when the connection was surrendered. The ITFG had previously clarified that although most customers would not surrender their connection, the electricity company did not have an unconditional right to defer the settlement of the deposit. Therefore, it would be classified as a 'current liability'.

In its revised bulletin 5, the ITFG has withdrawn this issue since the concept of current and non-current classification of assets and liabilities already existed under previous GAAP and is included in the 'General Instruction For Preparation Of Balance Sheet' in Schedule III of the Companies Act, 2013 (Schedule III). Hence, this issue does not pertain to transition from previous GAAP to Ind AS. Companies should therefore apply the principles for current and non-current classification based on the definitions provided in Ind AS and in Schedule III.

2) Issue No. 4: Accounting for processing fees by a company availing deemed cost exemption of PPE

In bulletin 5, the ITFG considered a situation wherein a company had taken a loan prior to the date of transition to Ind AS and had capitalised the processing fees on the loan as part of the relevant fixed assets. The company chose to avail the deemed cost exemption provided in paragraph D 7AA of Ind AS 101, First-time Adoption of Indian Accounting Standards to continue with the carrying value of the Property, Plant and Equipment (PPE) as per the previous GAAP.

Paragraph D 7AA of Ind AS 101 requires that no further adjustments should be made to the deemed cost of the PPE for transition adjustments that may arise from the application of other Ind AS. On this basis, the ITFG had previously clarified that no adjustments would be made to the carrying amount of the PPE. However, since the company would need to apply the requirements of Ind AS 109, Financial Instruments retrospectively for all loans outstanding on the transition date, the processing fees would be deducted from the loan amount to arrive at its amortised cost. Accordingly, this adjustment to the loan amount would have to be recognised in the retained earnings.

The ITFG revisited this issue and the revised bulletin 5 clarifies that the processing fees should be adjusted in both the loan amount as well as in the carrying amount of the PPE.

Overview of clarifications provided by ICAI (cont…)

The ITFG clarified that adjustment to PPE would be in the nature of a consequential adjustment (to PPE) to enable an adjustment to the carrying amount of the loan as required by Ind AS. This would also reflect the correct economic reality and result in faithful representation of the effects of these transactions on transition to Ind AS. Hence, this consequential adjustment (to PPE) would not be considered as an adjustment to the deemed cost of PPE as envisaged in paragraph D 7AA of Ind AS 101.

Accordingly, the carrying amount of the PPE as at the date of transition should be reduced by the amount of processing cost (net of cumulative depreciation impact). The difference between the adjustments to the carrying amount of the loan and PPE, respectively should be recognised in retained earnings.

3) **Issue No. 5: Accounting for government grant by a company availing deemed cost exemption of PPE**

In bulletin 5, the ITFG considered a situation wherein a company had received an asset related government grant prior to the date of transition to Ind AS and had deducted the grant received from the carrying amount of fixed assets, as permitted under previous GAAP. The company chose to avail of the deemed cost exemption provided in paragraph D 7AA of Ind AS 101, to continue with the carrying value of PPE as per the previous GAAP.

As per Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance, an asset related grant should not be deducted from the cost of PPE and instead, should be accounted for as a deferred income. Paragraph D 7AA of Ind AS 101 requires that no further adjustments should be made to the deemed cost of PPE for transition adjustments that may arise from the application of other Ind AS. Therefore, the ITFG had previously clarified that no adjustments would be made to the carrying amount of PPE. In accordance with Ind AS 20, the company would however be required to account for deferred income in respect of the grant outstanding on the transition date. Accordingly, the corresponding adjustment would have to be recognised in the retained earnings.

The ITFG revisited this issue and the revised bulletin 5 clarified that unamortised deferred income should be recognised and a corresponding adjustment should be recognised in PPE and retained earnings, respectively.

Accordingly, while there is no change in the accounting treatment for the deferred income (as per bulletin 5), the carrying amount of the PPE as at the date of transition would be increased by the amount of government grant deducted as per previous GAAP (net of cumulative depreciation impact). The difference between the adjustments would be recognised in retained earnings as at the date of transition. The ITFG clarified that the adjustment to PPE would reflect the correct economic reality and result in faithful representation of the effects of these transactions on transition to Ind AS.

FAQ on treatment of securities premium account under Ind AS on date of transition

In this FAQ, ICAI considered a situation wherein a company had issued (prior to the date of transition to Ind AS) non-convertible debentures redeemable at a premium. In the past, the company had utilised the securities premium account to provide for debenture redemption premium and for writing off debenture issue expenses as per Section 78 of the Companies Act, 1956 and Section 53 of Companies Act, 2013.

On transition to Ind AS, these debentures are classified and measured at amortised cost in accordance with Ind AS 109. Accordingly, the company would have to apply the Effective Interest Method (EIM) with retrospective effect from the date of issue of debentures to arrive at their amortised cost on the date of transition. Since the company had previously adjusted the entire amount of debenture redemption premium payable from the securities premium account, the carrying amount of the non-convertible debentures as per Indian GAAP would be higher as compared to the amortised cost on the date of transition.

Ind AS 101 states that where the accounting policies that an entity uses in its Ind AS opening balance sheet differ from those that it used for the same date as per its previous GAAP, the adjustment on account of the difference in the accounting policies would be recognised directly in retained earnings or another category of equity at the date of transition to Ind AS. Accordingly, the FAQ clarifies that the appropriate component of equity in this scenario, is the securities premium account. Accordingly on transition to Ind AS, the excess carrying value of the financial liability as per Indian GAAP over the amortised cost based on the EIM as per Ind AS 109 would be reversed by crediting the securities premium account with corresponding debit to the relevant account which was credited earlier (i.e. the debenture liability).

Our comments

The revised clarifications provided by ITFG are expected to assist companies that are in the process of finalising their annual Ind AS financial results for the year ended 31 March 2017. However, companies that have published their audited year-end financial results prior to the issuance of the clarifications may be required to evaluate the impact of these clarifications on the audited year-end financial results.

Further, companies that are yet to finalise their March 2017 quarter and are accordingly planning to consider the impact of the clarifications on their annual audited financial results, would need to comply with the requirements of Ind AS 8 Accounting Policies, Changes in Accounting Estimates and Errors. Consequently, following information may be required to be provided as part of the audited financial results for the year ended 31 March 2017:

- Three months of the period ended 31 March 2017 – as per the new accounting policy
- Three months of the period ended 31 December 2016 – restated as per the new accounting policy
- Three months of the period ended 31 March 2016 - restated as per the new accounting policy
- Year-to-Date (YTD) figures for current period ended 31 March 2017 - as per the new accounting policy
- Previous year ended 31 March 2016 - restated as per the new accounting policy.

Additionally, companies may be required to provide necessary disclosures as per Ind AS 8 in relation to changes in accounting policies.

The ITFG clarifications may also require companies to consider the following:

- Under previous GAAP, companies presented security deposits collected from customers (in relation to utilities such as electricity etc.) as non-current based on the FAQs on the Revised Schedule VI issued by the ICAI on 22 May 2012.

  The original clarification issued as part of Bulletin 5 by the ITFG appeared to suggest that companies would now be required to present such deposits as current liabilities.

  However, while the withdrawal of the clarification by ITFG seems to support a non-current classification of such security deposits, the subsequent withdrawal of the FAQs on Revised Schedule VI by the ICAI on 25 April 2017 may result in companies having to determine the classification purely based on the requirements of Ind AS 1 and Ind AS Schedule III to the Companies Act. Specific clarifications from the ICAI/ITFG may help in achieving consistency in this matter.

- The clarifications relating to loan processing fees and government grants are expected to provide relief to companies that had elected to apply the deemed cost exemption to continue with the previous GAAP carrying amount of PPE on transition to Ind AS. Previously, the clarifications in ITFG's bulletin 5 would have resulted in an asymmetrical accounting outcome for these items since companies would have been required to adjust retained earnings for the impact of loan processing fees/government grant without any corresponding adjustment to the carrying amount of PPE. The clarifications in ITFG's revised bulletin 5 now enable companies to reflect these consequential adjustments in PPE.

  Companies may however also be required to consider the impact of the above clarifications on other exemptions which offer a previous GAAP carrying value deemed cost option, e.g. investment in equity shares of subsidiaries, associates and joint ventures.

- The FAQ issued by ICAI reiterates the accounting treatment that was considered in ITFG's bulletin 2. Companies that have previously adjusted the entire redemption premium against the securities premium account and recognised the full liability, are therefore required to reverse the unamortised premium expense on transition to Ind AS. This would subsequently be recognised as an interest expense through statement of profit and loss over the remaining period until the redemption of the debentures. This may have a significant impact on the determination of future profits under Ind AS.

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The website provides information and resources to help board and audit committee members, executives, management, stakeholders and government representatives gain insight and access to thought leadership publications that are based on the evolving global financial reporting framework.

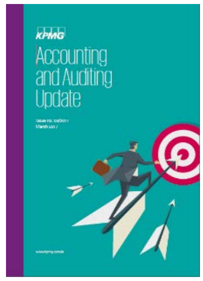
Voices on Reporting

KPMG in India is pleased to present Voices on Reporting – a monthly series of knowledge sharing calls to discuss current and emerging issues relating to financial reporting.

In our recent call on Wednesday, 5 April 2017, we covered key financial reporting and regulatory matters that are expected to be relevant for stakeholders as they approach the quarter ending 31 March 2017.

Our call included updates from the Ministry of Corporate Affairs (MCA), the Securities and Exchange Board of India (SEBI), the Reserve Bank of India (RBI), etc.

Missed an issue of our Accounting and Auditing Update or First Notes



Issue no. 8/2017 – March 2017

Continuing with our series of articles on the revised requirements of the Companies Act, 2013 (2013 Act), this month's edition of the Accounting and Auditing Update (AAU) carries an article on the requirements relating to Corporate Social Responsibility (CSR) under the 2013 Act. Our article summarises the requirements, amendments, clarifications and frequently asked questions issued by the Ministry of Corporate Affairs (MCA) on this topic.

Our article examines an important accounting matter relating to the factors to consider while determining if entities such as e-commerce companies and trading companies are acting as an agent or a principal based on the principles of Ind AS.

Our article also features an interaction with Mr. Ashish Chauhan, MD and CEO, BSE Ltd. Our conversation with him explores the incentives and value propositions of International Financial Service Centre (IFSC), opportunities available to Small and Medium Enterprises (SMEs) to list, various regulatory changes and reporting requirements.

Our publication also brings you the highlights of the Second Annual KPMG Accounting, Reporting and Compliance Conference.

The publication also carries regular round up of regulatory updates in India and internationally.

ICAI issues an implementation guide for auditor's reporting requirements on Specified Bank Notes post demonetisation

21 April 2017

The Ministry of Corporate Affairs (MCA) through its notification dated 30 March 2017 issued the following:

- Amendments to the Schedule III of the Companies Act, 2013 (2013 Act)
- The Companies (Audit and Auditors) Amendment Rules, 2017

The above notifications are applicable from 30 March 2017.

In light of the above, the Institute of Chartered Accountants of India (ICAI) has published an Implementation Guide (IG) on 15 April 2017 to provide guidance in respect of additional disclosure in the Schedule III to the 2013 Act and new Rule 11(d) of the Companies (Audit and Auditors) Amendment Rules (as explained above). The IG contains the following sections:

- Frequently Asked Questions
- Illustrative list of audit procedures
- Reporting scenarios
- Written representation.

This issue of First Notes provides an overview of the IG issued by the ICAI for auditor's reporting requirements on the SBN.

Previous editions are available to download from: www.kpmg.com/in