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IFRS Notes

Ind AS Transition Facilitation Group (ITFG) issues Clarifications Bulletin 9

29 May 2017

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Introduction

ITFG in its meeting considered certain issues received from the members of the Institute of Chartered Accountants of India (ICAI), and issued its Bulletin 9 on 16 May 2017 to provide clarifications on three issues in relation to the application of Indian Accounting Standards (Ind AS).

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 eight bulletins to provide guidance on issues relating to the application of Ind AS. This issue of IFRS Notes provides an overview of the clarifications issued by ITFG through its Bulletin 9.

Overview of the clarification in ITFG's Bulletin 9

The following issues relating to the application of Ind AS have been clarified in this bulletin.

1) **Treatment of dividend and dividend distribution tax in consolidated financial statements**

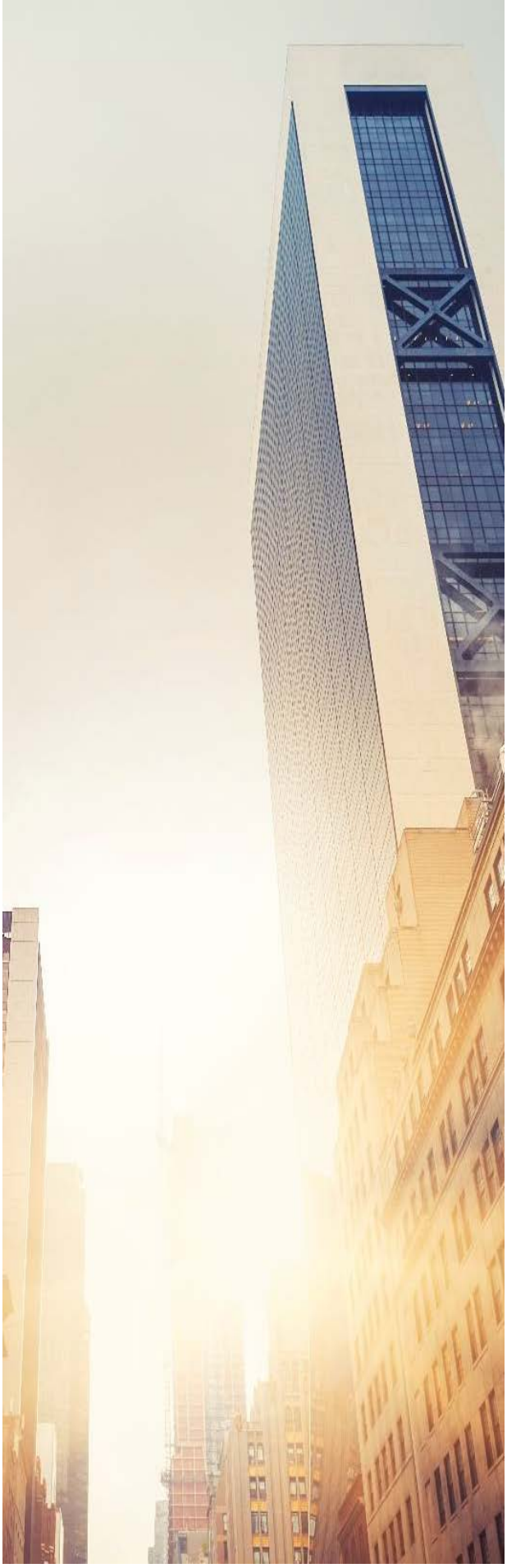
   ITFG considered an issue where a company (S Ltd.), which is a wholly owned subsidiary of an Indian company (P Ltd.) paid dividend of INR100,000 to its parent and a dividend distribution tax (DDT) thereon to the tax authorities of INR20,000.

   ITFG considered the accounting treatment of dividend and DDT paid by S Ltd. in the following circumstances:

   a) *In the consolidated financial statements of P Ltd.*

      Dividend distribution tax incurred by S Ltd. towards dividend paid to P Ltd.

      ITFG clarified that the dividend of INR100,000 paid by S Ltd., which was recorded as an income by P Ltd. in its separate financial statements and which was recorded by S Ltd. in its equity in its stand-alone financial statements, will be eliminated in the consolidated financial statements as a result of consolidation adjustments. The DDT of INR20,000 paid outside the consolidated group (to the tax authorities) will be charged as an expense in the consolidated statement of profit and loss (presuming that P Ltd. is unable to claim an offset against its own DDT liability).



Overview of the clarification in ITFG's Bulletin 9 (contd…)

In case P Ltd. claims the amount of the DDT paid by S Ltd. as an offset against its own DDT liability, the amount paid by S Ltd. is reflected in the consolidated statement of changes in equity.

Deferred tax on undistributed reserves

Ind AS 12 requires recognition of deferred tax liability on the undistributed reserves of subsidiaries except where the parent is able to control the timing of reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

However, in case the board of directors of a subsidiary propose to declare dividend for the previous financial year, to the extent of such proposed dividend, the temporary difference (in relation to DDT liability) is considered to be probable to reverse.

In case where the parent is likely to claim the DDT paid by the subsidiary as an offset against its own DDT liability, the ability to claim offset is subject to receipt of approval from the shareholders of the parent (approval of dividend at the annual general meeting).

Accordingly, while the ITFG has clarified that P Ltd. may be required to recognise deferred tax liability in the consolidated financial statements (measured based on the DDT expense of S Ltd.) to the extent of proposed dividend of S Ltd., recognition of deferred tax asset to the extent of offset may not be recognised pending receipt of approval from shareholders of P Ltd.

This may result in volatility in the consolidated statement of profit and loss as the deferred tax liability would be recognised in one year and would subsequently be reversed in the next year, while the actual expense may continue to be reflected in the consolidated statement of changes in equity or consolidated statement of profit and loss depending on whether the parent is able to claim offset (refer discussion in the previous section).

b) *In the stand-alone financial statements of P Ltd. and its subsidiary S Ltd.*

The treatment of DDT in the stand-alone financial statements of the parent entity and its subsidiary has been dealt with in the FAQ issued by the Accounting Standards Board of ICAI.

2) Accounting for business combinations of entities under common control

ITFG considered two situations with respect to common control business combinations:

a) Situation 1: Where a company (A Ltd.) has two subsidiaries (B Ltd. and C Ltd), and B Ltd. merges with C Ltd.

b) Situation 2: Where a company (A Ltd.) has a subsidiary (B Ltd.), and B Ltd. merges with A Ltd.

The issue under consideration was whether the carrying amount of assets and liabilities of the combining entities should be reflected as per the stand-alone financial statements of the entities transferred or as appearing in the financial statements of the ultimate parent.

Situation 1: ITFG clarified that for the purpose of this issue, reference should be given to paragraph 9(a)(i) of Appendix C of Ind AS 103, *Business Combinations* (*Business Combinations of Entities under Common Control*), which states that the 'assets and liabilities of the combining entities are reflected at their carrying amounts'. Accordingly, in the separate financial statements of C Ltd. (post-merger), the carrying values of the assets and liabilities of the entities being combined (i.e. B Ltd. and C Ltd.), will be as appearing in their stand-alone financial statements.

Situation 2: ITFG clarified that when a subsidiary (B Ltd.) merges with its parent (A Ltd.), nothing changes, and the transaction only means that the assets, liabilities and reserves of B Ltd., which were appearing in the consolidated financial statements of Group A immediately before the merger, would now be a part of the separate financial statements of A Ltd. and separate financial statements of A Ltd. to the extent of this common control transaction would be considered as a continuation of the consolidated group. Accordingly, it would be appropriate to recognise the carrying value of the assets, liabilities and reserves pertaining to B Ltd. as appearing in the consolidated financial statements of Group A.

ITFG also stated, that the legal merger of a subsidiary with its parent or legal merger of fellow subsidiaries is an intra-group transaction. As per Ind AS 110, *Consolidated Financial Statements*, all intra-group transactions should be eliminated in preparing consolidated financial statements. Hence, in both the given situations, the effect of legal merger is required to be eliminated while preparing the consolidated financial statements of A Ltd.

Overview of the clarification in ITFG's Bulletin 9 (contd…)

3) Treatment of government grant in the case of a government company

Accounting Standard (AS) 12, *Accounting for Government Grants*, required grants received with respect to an entity's total investment or total capital outlay, for which no repayment was ordinarily expected (i.e. grants in the nature of promoters' contribution), to be credited directly to the shareholders' funds.

Under Ind AS 20, *Accounting for Government Grants and Disclosure of Government Assistance*, entities are required to recognise the grants received in the statement of profit and loss over the periods in which the entity recognises the related expenses or costs for which the grants are intended to compensate.

In this context, ITFG clarified the accounting for government grants by considering a situation, wherein a government company (ABC Co., which was wholly owned by the government) had received contributions from the government in the nature of promoters' contribution. It had recognised this contribution in capital reserve and treated it as part of shareholders' funds in accordance with AS 12.

The issue under consideration was to determine the accounting treatment for such grants received, under Ind AS 20, where they were received prior to the date of transition to Ind AS, and the accounting treatment for similar grants received post transition to Ind AS.

ITFG clarified, that since the government had 100 per cent shareholding in the entity, the entity should determine whether the payment received was as a government grant or as a shareholder's contribution. Following would be the accounting treatment in the two scenarios:

a) Where the entity concludes that the contribution is in the nature of a government grant, it would apply the principles of Ind AS 20 retrospectively, as required by Ind AS 101, *First-time Adoption of Indian Accounting Standards*. Ind AS 20 requires all grants to be recognised as income on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate. Unlike AS 12, Ind AS 20 requires the grant to be classified either as a capital or an income grant and does not permit recognition of government grants in the nature of promoter's contribution directly in shareholders' funds.

b) Where the entity concludes that the contribution is in the nature of 'shareholder contributions', Ind AS 20 would not apply, since it specifically scopes out the participation by the government in the ownership of an entity. Thus, in accordance with Ind AS 101, the entity is required to reclassify the contribution received, from capital reserve to an appropriate category under 'other equity' at the date of transition to Ind AS.

ITFG clarified that the same principles as mentioned above would apply for contributions received by an entity subsequent to the transition date.

Our comments

ITFG clarifications are expected to resolve various practical implementation issues faced by several companies transitioning to Ind AS. The companies should consider the interpretations provided by ITFG in their implementation efforts. However, it should be noted that some of the issues are quite judgemental and would require consideration of facts and circumstances while analysing each individual situation.

Some of the implementation challenges could be as follows:

a) **Timing of determining the parent's DDT liability when dividend distribution is probable:** ITFG has opined that a parent entity's ability to claim the benefit of DDT liability paid by the subsidiary is not established till the time shareholders' approve declaration of dividend. Shareholders would declare dividend at the Annual General Meeting (AGM) which is post the finalisation of the financial statements. Accordingly, companies who were recognising both, a deferred tax liability towards the subsidiary's DDT liability and a deferred tax asset towards the offset to be claimed in the future period may now be required to evaluate the impact of this clarification on their respective financial statements. This may also create significant volatility in the consolidated statement of profit and loss especially in cases where the subsidiary declares a large one off dividend.

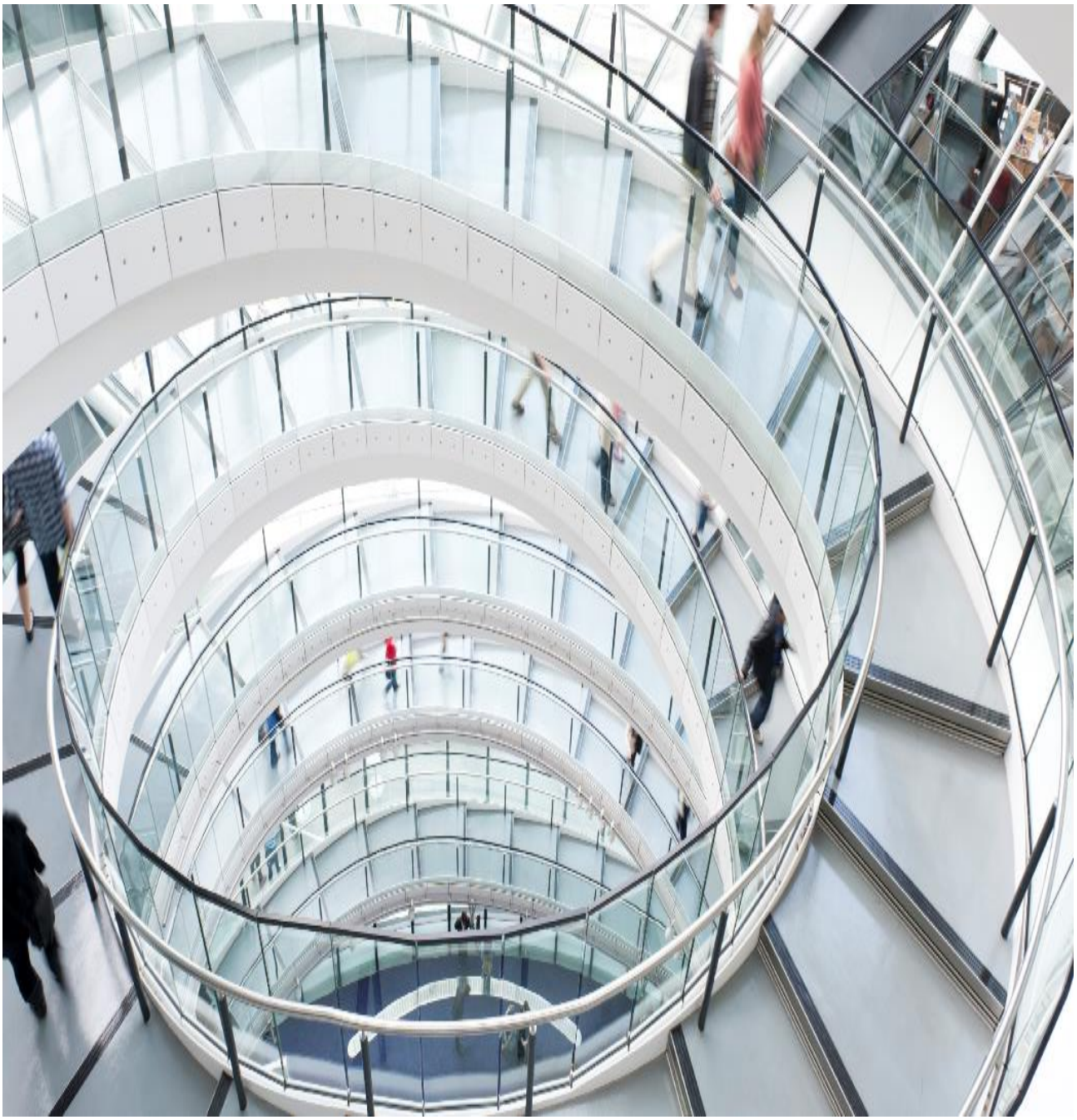
   Additionally, for the purpose of interim financial statements, necessary adjustment to the effective tax rates may be required to be considered.

Our comments (contd…)

b) **Common control business combinations and carrying values of the combining entities:** Under IFRS, there is no guidance on accounting for legal mergers or common control business combinations. However, internationally practices have developed where it is acceptable to choose an accounting policy (to be applied consistently) to determine book values of assets and liabilities of the combining entities (depending on the nature of the common control transaction) from the financial statements of the following:

- Ultimate parent
- Entity transferred
- Intermediate parent (if any).

However, it appears that the ITFG clarification restricts Indian companies to the approaches laid down in Bulletin 9. Accordingly, companies who are contemplating a restructuring or are in the process of completing a restructuring may have to evaluate the impact of this clarification on their respective financial statements.



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KPMG in India's IFRS institute

Visit KPMG in India's IFRS Institute - a web-based platform, which seeks to act as a wide-ranging site for information and updates on IFRS implementation in India.

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

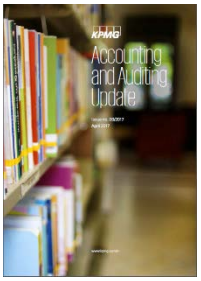
KPMG in India is pleased to present Voices on Reporting – a monthly series of knowledge sharing calls to discuss current and emerging issues relating to financial reporting.

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.

In our VOR yearly updates, we have summarised key updates relating to the year ended 31 March 2017 from the MCA, the SEBI, the RBI, the Institute of Chartered Accountants of India (ICAI), the Insurance Regulatory and Development Authority of India (IRDA) and the Central Board of Direct Taxes (CBDT).

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



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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 highlighting the regulatory requirements with regard to acceptance of deposits.

This edition carries an article on accounting for prior period errors and explains the guidance with the help of illustrative examples. It also carries an article on accounting for changes in accounting policies, estimates and prior period errors.

Our article explains the accounting treatment of foreign currency translation reserve in various scenarios e.g. on first-time adoption of Ind AS, disposal, impairment, restructuring, etc. of a foreign operation.

The IFRS 8, Operating Segments standard under International Financial Reporting Standards (IFRS) focusses on segment disclosures based on the components of the entity that management monitors in making decisions about operating matters. The International Accounting Standards Board (IASB) conducted a Post Implementation Review (PIR) of IFRS 8 in July 2013. As a follow up of PIR, the IASB proposed certain amendments to IFRS 8. Our article summarises the amendments proposed by the IASB.

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

CBDT issues draft ICDS on real estate transactions

15 May 2017

On 31 March 2015, the Ministry of Finance (MoF) issued 10 Income Computation and Disclosure Standards (ICDS) operationalising a new framework for computation of taxable income by all assessees other than an individual or a Hindu Undivided Family who is not required to get his/her accounts of the previous year audited in accordance with the provisions of Section 44AB of the Income-tax Act, 1961 (IT Act). The ICDS are applicable to the specified assessees from Assessment Year (AY) 2017-18.

The Committee vide a press release dated 11 May 2017 has issued the draft ICDS on real estate transactions (draft ICDS). The draft ICDS is based on the Guidance Note issued on Real Estate Transactions (ICAI GN) issued by ICAI in 2012. For the purposes of providing uniformity, certainty and harmonising the same with provisions of the IT Act, the Committee suggested certain changes in draft ICDS in comparison to the ICAI GN.

The draft ICDS is open for comments from stakeholders till 26 May 2017.

This issue of First Notes provides an overview of the draft ICDS issued by the MoF.

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