



IFRS Notes

**Ind AS Transition Facilitation
Group (ITFG) issues
Clarifications Bulletin 11**

21 August 2017

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Introduction

The ITFG in its meeting considered certain issues received from the members of the Institute of Chartered Accountants of India (ICAI), and issued its Bulletin 11 on 1 August 2017 to provide clarifications on nine issues in relation to the application of Indian Accounting Standards (Ind AS).

Background

With Ind AS being applicable to corporates in a phased manner from 1 April 2016, the 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 (2015 Rules).

Over the past year, ITFG issued 10 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 11.

Overview of the clarifications in ITFG's Bulletin 11

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

1) Computation of net worth of a company to assess applicability of Ind AS

The 2015 Rules have specified the criteria for applicability of Ind AS to certain classes of companies. One of the criteria determining the applicability of Ind AS is based on the net worth of a company. However, the 2015 Rules have not defined net worth, but they give reference to the definition of net worth in the Companies Act, 2013 (2013 Act) for calculating net worth for the purposes of Ind AS road map applicability.

As per the 2013 Act, net worth is the aggregate of paid-up share capital, all reserves created out of profits and securities premium. This is net of accumulated losses and miscellaneous and deferred expenditure, to the extent not written off. The definition specifically excludes reserves created out of revaluation of assets, write-back of depreciation and amalgamation.

In view of the above, ITFG clarified that the Employee Stock Options Plans (ESOP) reserve created as per the previous generally accepted accounting principles in India (previous GAAP), in accordance with the Guidance Note on Accounting for Employee Share-based Payments (the Guidance Note), is a transitional account. On fulfilment of the ESOP conditions, it will ultimately be transferred to another equity account, such as share capital, securities premium and/or general reserve, as would be recommended by the Guidance Note.



Overview of the clarification in ITFG's Bulletin 11 (contd...)

Accordingly, for the sole purpose of determining whether Ind AS is applicable to a company, the ESOP reserve should be included while calculating the net worth of the company.

The ITFG has reiterated that this clarification is only for the purpose of Ind AS applicability and should not be applied by analogy for determining net worth under the provisions of the 2013 Act.

2) Applicability of Accounting Standard Interpretations (ASI) issued under previous GAAP to situations of tax holiday under Ind AS

Under previous GAAP, ASIs were issued to deal with certain practical difficulties arising out of application of the accounting standards. Therefore, ASI 3, *Accounting for Taxes on Income in the situations of Tax Holiday under Sections 80-IA and 80-IB of the Income Tax Act, 1961* and ASI 6, *Accounting for Taxes on Income in the context of Section 115JB of the Income Tax Act, 1961* were issued by ICAI to provide guidance on applicability of AS 22, *Accounting for Taxes on Income* in situations of tax holiday under section 80-IA and 80-IB of the Income Tax Act, 1961.

The ASI 3 clarified that deferred taxes in respect of timing differences which reverse during the tax holiday period should not be recognised to the extent the company's gross total income is subject to the deduction during the tax holiday period. However, timing differences which reverse after the tax holiday period should be recognised in the year in which the timing differences originate.

The ITFG clarified that ASI 3 has become part of AS 22, by way of an explanation to paragraph 13. Additionally, ASI are not effective in the context of Ind AS. Under Ind AS, to determine the treatment of deferred taxes in the tax holiday period, the principles enunciated in Ind AS 12, *Income Taxes* are required to be applied. Accordingly, under Ind AS, deferred taxes in respect of temporary differences that reverse during the tax holiday period should not be recognised in the financial statements to the extent the entity's gross total income is subject to deduction during the tax holiday period as per the requirement of Section 80-IA/80-IB of the Income Tax Act, 1961.

3) Calculation of earnings per share by a subsidiary company that is not wholly owned by its parent

Paragraph 9 of Ind AS 33, *Earnings per Share* *inter alia* states that an entity shall calculate basic earnings per share amounts for profit or loss attributable to ordinary equity holders of the

parent entity. The ITFG clarified that the requirements of paragraph 9 of Ind AS 33 have been provided with respect to the calculation of Earnings Per Share (EPS) in the consolidated financial statements of an entity. Accordingly, a subsidiary company, which is not fully owned (the subsidiary company), should calculate and present its basic EPS as below:

- **Separate financial statements:** In case of separate financial statements, 'parent entity' mentioned in paragraph 9 would imply the legal entity of which separate financial statements are being prepared. Accordingly, when an entity presents its EPS in its separate financial statements, then the EPS would be calculated based on the profit or loss attributable to its equity shareholders.
- **Consolidated financial statements:** For the purpose of calculating EPS based on consolidated financial statements, the an entity would consider profit or loss attributable to the ordinary equity holders of the parent entity and if presented, profit or loss from continuing operations attributable to those equity holders. Profit or loss attributable to the parent entity refers to profit or loss of the consolidated entity after adjusting profit attributable to non-controlling interests.

4) Measurement of investments in subsidiaries, joint ventures and associates at the end of the first Ind AS financial reporting period

Under Ind AS, when an entity prepares separate financial statements, Ind AS 27, *Separate Financial Statements* requires it to account for its investments in subsidiaries, joint ventures and associates either at cost or in accordance with Ind AS 109, *Financial Instruments*.

The ITFG considered a situation where a company (MNC Ltd.), at the date of transition to Ind AS, opted to measure its investment in a subsidiary in its separate financial statements at deemed cost, as per paragraph D15 of Ind AS 101, *First-time Adoption of Indian Accounting Standards*. The issue under consideration was, whether the company has an option to measure its investment in subsidiary at the end of its first Ind AS financial reporting period as per Ind AS 109, when it prepares its separate financial statements.

At the date of transition to Ind AS and subsequent investments in subsidiaries

The ITFG clarified that Ind AS 101 requires an entity to use the same accounting policies in its opening Ind AS balance sheet, and throughout all periods presented in its first Ind AS financial statements.

Overview of the clarification in ITFG's Bulletin 11 (contd...)

In this case, MNC Ltd. opted to measure its investment in its subsidiary at deemed cost, then it should carry such an investment at the amount (i.e. deemed cost) in its first Ind AS financial statements as at the end of the reporting period.

In accordance with Ind AS 27, the same accounting treatment should be applied for each category of investments. Accordingly, in the case of MNC Ltd., all subsequent investments made in subsidiaries, will also be measured at cost at the end of the reporting period (if deemed cost accounting policy was followed by the entity at the date of transition).

Investments in associates or joint ventures

Similar considerations apply to accounting of investments in associates and joint ventures as explained for investments in subsidiaries above. Therefore, MNC Ltd. has an option to account for investments made in different category (e.g. associate or joint venture) either at cost or in accordance with Ind AS 109.

5) Accounting treatment of exemption from duties and taxes under export promotion capital goods scheme

The ITFG considered a situation where a company (MNC Ltd.) was exempt from payment of customs duty on import of capital goods, provided it fulfilled certain conditions related to export of goods under the Export Promotion Capital Goods (EPCG) scheme of the Government of India. The issues under consideration were, whether the exemption from payment of customs duty could be considered as a government grant, in accordance with Ind AS 20, *Government Grants and Disclosure of Government Assistance*, and if it were so considered, would the grant be related to an asset or related to income. The ITFG also analysed the accounting treatment to be provided to the government grant in either case.

Government grant

The ITFG clarified that the exemption of customs duty under the EPCG scheme would be considered as a government grant, since it was an assistance provided by the government in return for compliance with certain conditions relating to the operating activities of the company and could be reliably measured.

Classification and accounting of government grant

The ITFG noted that the classification of a grant as related to an 'asset' or 'income' would require exercise of judgement and careful examination of the facts, objectives and conditions attached to the scheme of the government. MNC Ltd. would be required to ascertain the purpose of

the grant and the costs which it intends to compensate.

The ITFG reiterated the guidance provided in Ind AS 20 as follows:

- **Grant related to assets:** Where the entity concludes that the grant is related to assets, it will present it in the balance sheet as deferred income. The deferred income will be recognised in the statement of profit and loss on a systematic basis over the useful life of the asset.
- **Grant related to income:** Where the entity concludes that the grant is related to income, it will present the grant in the statement of profit and loss, either separately or under a general heading such as 'other income'. Alternatively, it may be deducted in reporting the related expenses.

Based on the evaluation of the company in this case, the accounting and presentation of the grant would be as below:

- **Export of goods:** If the grant received is to compensate the import cost of assets, and is subject to an export obligation as prescribed in the EPCG scheme, then the recognition of the grant would be linked to fulfilment of the associated export obligations.
- **Compensation of import cost of an asset:** If the grant received is to compensate the import cost of the asset, and it can be reasonably concluded that conditions relating to export of goods are subsidiary conditions, then it is appropriate to recognise such grants in profit or loss over the life of the underlying asset.

6) Consolidation of financial statements of a subsidiary following a different method of depreciation

The ITFG considered a situation where a subsidiary company (PQR Ltd.) had adopted the Straight-line Method (SLM) of depreciation, whereas its parent (MNC Ltd.) had adopted the Written-Down Value (WDV) method of depreciation. The issue analysed by ITFG was, how the Property, Plant and Equipment (PPE) be depreciated in the consolidated financial statements of MNC Ltd.

Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, states that the depreciation method used by an entity should reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. A change in such a method would be accounted for as a change in an accounting estimate of the entity.

Overview of the clarification in ITFG's Bulletin 11 (contd...)

In view of the above, ITFG clarified that selection of the method of depreciation is an accounting estimate, and not an accounting policy. Though Ind AS 110, *Consolidated Financial Statements* requires members of the group to use uniform accounting policies for like transactions and other events in similar circumstances, this requirement is not applicable for accounting estimates made while preparing financial statements. Accordingly, a subsidiary can have a different method of estimating depreciation for PPE, if its expected pattern of consumption is different. The method once selected in the stand-alone financial statements of the subsidiary should not be changed while preparing the consolidated financial statements.

Accordingly, in the given case, PPE of PQR (subsidiary company) may be depreciated using straight-line method and PPE of parent company (MNC Ltd.) may be depreciated using WDV method, if such method closely reflects the pattern of consumption of future economic benefits embodied in the respective assets.

7) Applicability of Ind AS to non-corporate entities

The ITFG considered a situation where a company (A Ltd.) which was a first time adopter of Ind AS, had incorporated a partnership firm (M/s A & B Associates) with another company (B Ltd.). The ITFG analysed whether Ind AS would be applicable to M/s A & B Associates by virtue of the fact that Ind AS was applicable to A Ltd.

The ITFG clarified that according to the Ind AS road map issued by MCA, Ind AS is applicable to corporates only, and non-corporates cannot apply it voluntarily. However, where a relevant regulator specifically provides for implementation of Ind AS, the non-corporate entities would be required to apply the same. In the current case, Ind AS would not be applicable to M/s A & B Associates and hence, it would not prepare Ind AS financial statements. However, for the purpose of consolidation, it will be required to provide its financial statements data prepared as per Ind AS to A Ltd if it qualifies as a subsidiary/joint venture/associate of A Ltd.

8) Treatment of enabling assets in the financial statements of an entity

The ITFG considered a situation wherein a company (ABC Ltd.) was setting up a new refinery outside the city limits. In order to facilitate the construction of the refinery and its operations, it was required to incur/contribute to the expenditure on the construction/development of railway sidings, roads and bridges (enabling assets). ABC Ltd. did not have

ownership rights on the railway sidings, road and bridges, and these would be available for use to other entities and public at large. The issues under consideration were as follows:

- Manner of capitalisation of enabling assets
- Presentation of enabling assets
- Depreciation of enabling assets?

Capitalisation of enabling assets

Ind AS 16, *Property, Plant and Equipment* prescribes that an item may be capitalised as PPE, if it is probable that future economic benefits associated with it will flow to the entity, and the cost of the item can be measured reliably. Further, any costs directly attributable to bring the asset to the location and condition necessary for it to be capable of operating in the manner intended by the management would form part of the cost of the PPE.

In this context, ITFG clarified that though ABC Ltd. cannot restrict others from using the railway sidings, roads and bridges, these are required to facilitate the construction of the refinery and for its operations. Expenditure on these items is required to be incurred in order to get future economic benefits from the project as a whole. Hence, these expenses should be capitalised in the financial statements of ABC Ltd. It is apparent that the aforesaid expenditure is directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

Presentation of enabling assets

Since ABC Ltd. is not able to restrict others from using the asset, it cannot capitalise them as individual items of PPE. Accordingly, the expenditure incurred will be considered as a cost of constructing the refinery and accordingly, will be allocated to and capitalised as a part of the items of PPE of the refinery. These assets would be presented within the class of asset to which they relate.

Depreciation of enabling assets

Ind AS 16 requires that an item of PPE with a cost that is significant in relation to the total cost of the PPE should be depreciated separately (component accounting). Accordingly, the enabling assets will be depreciated as below:

- **Useful life is different:** If the components have a useful life which is different from the useful life of the PPE to which they relate, they should be depreciated separately over their useful life. The useful life, however should not exceed that of the asset to which they relate.

Overview of the clarification in ITFG's Bulletin 11 (contd...)

- **Useful life and depreciation method is same:** If the components have a useful life and depreciation method that are same as the useful life and depreciation method of the PPE, then they may be grouped with the related PPE and depreciated as a single component.
- **Directly attributable costs:** Where the components have been included in the cost of PPE as a directly attributable cost, then they should be depreciated over the useful life of the PPE. The useful lives of components should not exceed that of the asset to which it relates.

9) Disclosure of sitting fees paid to independent and non-executive directors

As per Ind AS 24, *Related Party Disclosures*, Key Management Personnel (KMP) includes all directors (executive or otherwise) of an entity who are having direct or indirect authority and

responsibility for planning, directing and controlling the activities of the entity. It further requires entities to disclose the compensation of the KMP, including short-term employee benefits in the financial statements of the entity.

Ind AS 19, *Employee Benefits* defines short-term employee benefits as those items that are expected to be settled wholly before 12 months after the end of the annual reporting period in which the employees/directors render the related services, and includes wages, salaries, social security contributions, paid annual and sick leaves, profit-sharing and bonus and other non-monetary benefits.

In the above context, independent and non-executive directors would be considered as KMP under Ind AS. Therefore, sitting fees paid to the directors will be required to be disclosed as per Ind AS 24, since they will fall under the definition of 'short-term employee benefits'.

Our comments

The ITFG clarifications are expected to resolve various practical implementation issues faced by several companies that have transitioned or are transitioning to Ind AS. Such companies should consider the interpretations provided by ITFG in their implementation efforts. However, it should be noted that some of the issues require the application of judgement based on a consideration of facts and circumstances while analysing each individual situation.

Specifically, companies may consider the following aspects:

- **Enabling assets:** The ITFG, in its second bulletin considered whether expenses incurred on construction of assets on land not owned by a company should be capitalised. The ITFG concluded that such a decision should be based on the principles of Ind AS 16 after consideration of facts and circumstances of each case. In bulletin 11, ITFG has reiterated this fact, and has clarified the manner of depreciation of the enabling assets that have been capitalised. It has further affirmed, that the useful life of the component cannot exceed the useful life of the related PPE for which the cost has been incurred.
- **Depreciation method is an accounting estimate under Ind AS:** Under Previous GAAP (for accounting periods ending upto 31 March 2016), method of depreciation was treated as an accounting policy and consequently, per the requirements of AS 21, *Consolidated Financial Statements*, method of depreciation as followed by the subsidiary was aligned with the method of depreciation as followed by the parent (if different) for the purposes of the consolidated financial statements.

Under Ind AS, given that the method of depreciation is treated as an accounting estimate, alignment of method of depreciation for consolidated financial statements may not be necessary i.e. the method of depreciation as applied by the subsidiary in the separate financial statements may continue to be applied in the consolidated financial statements, even in cases where the such method of depreciation is different from the method being applied by the parent.

However, in cases where the carrying value as of the date of transition per Previous GAAP has been considered as the deemed cost of property, plant and equipment in such cases, the written down value of the assets of the subsidiary may continue to be different in the separate financial statements of the subsidiary and the consolidated financial statements of the parent.

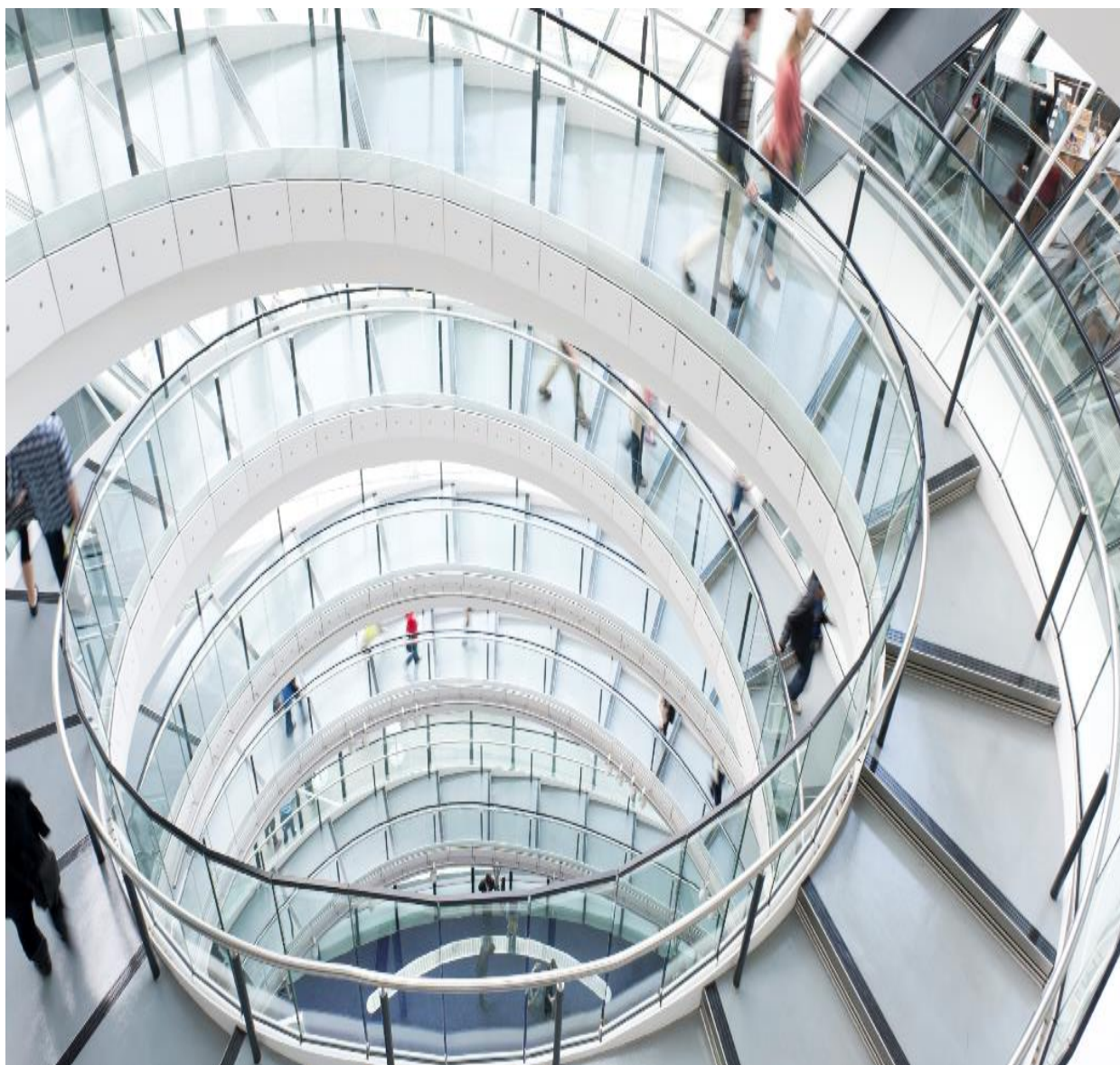
Further, given that AS 10 (Revised) is aligned with the requirements of Ind AS 16, the clarification may equally apply to companies preparing their financial statements per Indian GAAP.

- **Non-executive directors:** AS 18, *Related Party Disclosures*, defines KMP as persons who have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise. This generally includes the whole-time and executive directors and other personnel having the authority and responsibility to take decisions and control the activities of the enterprise.

Our comments (contd...)

However, this definition does not include non-executive directors. Ind AS 24 has brought in its scope non-executive and independent directors in the definition of KMP.

- **Export promotion capital goods scheme:** The ITFG specifies that these schemes would fall within the scope of government grants under Ind AS. Additionally, the accounting of such grants would be determined based on the facts and circumstances of each case i.e. whether the grants are related to assets or to income.
- **Accounting for investments in subsidiaries, associates and joint ventures:** In its separate financial statements, a parent entity may account for its investments in subsidiaries, associates and joint ventures either at cost or in accordance with Ind AS 109. Once it chooses the method of accounting for a particular category of investment, it needs to continue with the same accounting policy for that category of investment.
- **Applicability of Ind AS to non-corporate entities:** The ITFG has clarified that non-corporate entities cannot adopt Ind AS voluntarily unless required by a regulation. In certain sectors, for example, real estate and infrastructure, a group may make investments through partnership firms or other non-corporate entities. Therefore, entities in such sectors would need to continue to prepare multiple sets of financial statements both for statutory reporting (under accounting standards) and for parent's Ind AS reporting (under Ind AS). Maintenance of multiple financial statements could be burdensome for such non-corporate entities. Therefore, regulators of such non-corporate entities may consider to allow such entities to apply Ind AS for their statutory reporting too.



KPMG in India

Ahmedabad

Commerce House V, 9th Floor
902 & 903, Near Vodafone House
Corporate Road, Prahalad Nagar
Ahmedabad 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru

Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala,
Bengaluru 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh

SCO 22-23 (1st Floor)
Sector 8C, Madhya Marg
Chandigarh 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai

No.10, Mahatma Gandhi Road
Nungambakkam
Chennai 600 034
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Jaipur

Regus Radiant Centres Pvt. Ltd.
Level 6, Jaipur Centre Mall
B2 By Pass Tonk Road
Jaipur, Rajasthan 302 018
Tel: +91 141 710 3224

Gurgaon

Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurgaon,
Haryana 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad

Reliance Humsafar, 4th Floor
8-2-618/2 Road No.11,
Banjara Hills
Hyderabad 500 034
Tel: +91 40 3046 5000
Fax: +91 40 3046 5299

Kochi

Syama Business Center
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata

Unit No. 603 – 604, 6th Floor,
Tower - 1, Godrej Waterside,
Sector – V,
Salt Lake, Kolkata - 700 091
Tel: +91 33 44034000
Fax: +91 33 44034199

Mumbai

Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida

Unit No. 501, 5th Floor
Advant Navis Business Park
Tower B, Plot No. 07, Sector 142
Noida Expressway, Gautam Budh Nagar
Noida 201 305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune

9th Floor, Business Plaza
Westin Hotel Campus, 36/3-B
Koregaon Park Annex, Mundhwa Road
Ghorpadi, Pune 411 001
Tel: +91 20 6747 7000
Fax: +91 20 6747 7100

Vadodara

iPlex India Private Limited,
1st floor office space, No. 1004,
Vadodara Hyper, Dr. V S Marg
Alkapuri, Vadodara 390 007
Tel: +91 0265 235 1085/232 2607/
232 2672

You can reach out to us for feedback and
questions at:

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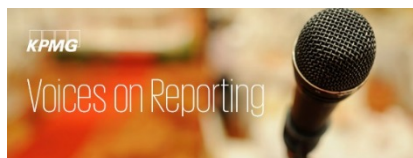
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Voices on Reporting



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.

Recently, the Central Board of Direct Taxes (CBDT) issued following circulars:

- Clarifications in the form of Frequently Asked Questions (FAQs) on issues relating to the levy of Minimum Alternate Tax (MAT) for Ind AS compliant companies
- Proposal for amendment to Section 115JB of the Income Tax Act, 1961 in relation to Ind AS compliant companies.

A special session of our Voices on Reporting webinar held on 3 August 2017 provided an overview of the implications of the above mentioned developments.

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



Issue no. 12/2017 – July 2017

This edition of Accounting and Auditing Update (AAU) analyses the impact of a Goods and Services Tax (GST) on Ind AS financial reporting.

As banks transition to Ind AS, they would need to compute effective interest on floating rate financial instruments under Ind AS 109, *Financial Instruments*. This a complex area of implementation and the standard does not prescribe an approach to compute Effective Interest Rate (EIR) in the case of floating rate financial instruments. In our article, we discuss alternative methods that banks may adopt for computing the EIR on floating-rate instruments held by them.

Our article emphasises the manner of selection and application of accounting policies along with disclosure requirements and how to present changes when there is a change in accounting policy.

Under the Companies Act, 2013 (2013 Act) section, we describe a provision relating to declaration and payment of dividend. The article also compares the requirements of the 2013 Act with the Securities and Exchange Board of India's (SEBI) regulations with regard to dividend.

Our publication also carries a regular synopsis of recent regulatory updates in India and internationally.



SEBI mandates disclosure of defaults on repayment of loans from banks by listed entities

16 August 2017

The SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 require disclosure of material events/information by listed entities to stock exchanges. Specific disclosures on certain matters such as delays and default in payment of listed non-convertible debentures, listed non-convertible preference shares, foreign currency convertible bonds and other similar types of debt instruments.

The Listing Regulations do not require the above disclosures to be provided in respect of loans from banks and financial institutions.

The SEBI, through its circular dated 4 August 2017 has mandated listed entities who have defaulted in payment of interest/instalment obligations on loans from banks and financial institutions, debt securities (including commercial paper), etc. to provide a disclosure of defaults to the stock exchanges within one working day from the date of the default in the manner prescribed in the circular.

This circular is effective from 1 October 2017.

This First Notes provides an overview of the new SEBI disclosure requirements.

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

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