



# Ind AS – ITFG interpretations and application issues

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# Background

## About Ind AS implementation in India

Indian financial reporting has undergone a paradigm shift with the introduction of Indian Accounting Standards (Ind AS). These involve application of several new and complex concepts, which require a significant level of judgement and estimation, accompanied by detailed qualitative and quantitative disclosures. However, this is just the beginning. The recent key amendments to the Companies Act, 2013 (2013 Act) and other Ind ASs that are on the verge of implementation (Ind AS 115, *Revenue from Contracts with Customers* and Ind AS 116, *Leases*), are expected to have a further impact on compliance as well as other accounting and reporting requirements across industries.

India Inc. is about to complete phase II of the Ind AS implementation. Our experience is that the real success of the convergence initiatives depends on how well these standards are implemented and how effectively companies embrace this change in both spirit and form.

## The Ind AS Transition and Facilitation Group (ITFG)

In the context of the above developments, the Accounting Standards Board (ASB) and the Ind AS Implementation Committee of the Institute of Chartered Accountants of India (ICAI) constituted the ITFG to provide clarifications on various issues related to the applicability of Ind AS and its implementation. These

issues are being raised by preparers, users and other stakeholders. Till date, ITFG has issued 14 bulletins covering implementation issues on various Ind AS such as, consolidation, financial instruments, business combinations, etc.

## About the publication

Ind AS provide extensive guidance and entail a significant change in the financial reporting framework applied by Indian companies to report their financial results. Their adoption requires a detailed level of analysis and companies will need to invest substantial time to ensure compliance.

Our publication 'Ind AS – ITFG interpretations and application issues' is designed to assist companies in understanding this guidance when preparing financial statements in accordance with Ind AS. The publication provides a brief overview of the Ind AS and highlights the key differences from the respective IFRS. Further, the publication summarises the clarification and recommendations provided by ITFG with respect to various implementation and interpretation issues pertaining to Ind AS (including certain frequently asked questions issued by ICAI). The publication is based on the Ind AS notified by the Ministry of Corporate Affairs (MCA), including amendments up to 15 February 2018. It also includes the 14 clarifications' bulletins that have been issued by ITFG till 15 February 2018.



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## Using the publication

The publication on Ind AS summarises the key principles and guidelines prescribed by the Ind AS. It contains 10 chapters, which provide an essence of the principles within Ind AS pertaining to each topic. Further, some chapters may contain multiple topics/Ind AS application issues. Each chapter includes the following sections:

### *Overview*

This section provides a brief overview of the significant principles prescribed within Ind AS covered by the chapter. It highlights key principles articulated in the specific Ind AS to assist preparers and other users of financial statements in understanding the significant requirements related to the topics covered in each chapter.

### *Significant differences from IFRS*

While Ind AS is largely converged with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB), there are certain additional requirements/exemptions provided in Ind AS, or certain requirements/exemptions provided in IFRS that have been excluded from Ind AS, known as 'carve-outs' from IFRS. These divergences from IFRS are intended to smoothen the implementation and applicability of the standards from an Indian context.

Post implementation of Ind AS, many corporates may continue to report internationally under the IFRS framework. This publication therefore highlights the significant differences from IFRS in each chapter.

### *Practical implementations arising out of ITFG clarifications*

This section summarises the various Ind AS clarifications issued by the ITFG in simple and easy to understand language. Our publication captures their essence by highlighting the key principles that emerge from the ITFG clarifications. These are expected to assist companies in effective implementation of Ind AS and provide a context for users of financial statements to better understand the information reported by companies under Ind AS.

### *Need for judgement*

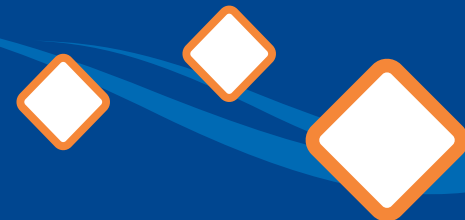
This publication intends to highlight some of the practical application issues with the help of certain facts and circumstances detailed in the examples used. In practice, transactions or arrangements involving Ind AS may be complex. Therefore, further interpretation and significant use of judgement may be required for an entity to apply Ind AS to its facts, circumstances and individual transactions. Further, some information contained in this publication may change as practice and implementation guidance continue to develop. Users are advised to read this publication in conjunction with the actual text of the standards and implementation guidance issued, and to consult their professional advisors before concluding on accounting treatments for their transactions.

## References

References to relevant guidance and abbreviations, when used, are defined within the text of this publication.

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# Consolidation of subsidiaries, associates and joint ventures



In India, the Companies Act, 2013 (2013 Act), mandates preparation of Consolidated Financial Statements (CFS) in addition to the requirement of preparing Separate Financial Statements (SFS), if a company has one or more subsidiaries, associates or joint ventures. Ind AS 110, *Consolidated Financial Statements*, carries the same requirement.

This chapter includes discussion on key practical implementation issues that relate to the following standards:

- Ind AS 110, *Consolidated Financial Statements*: This standard establishes the principles for the presentation and preparation of CFS, when an entity controls one or more other entities.
- Ind AS 28, *Investments in Associates and Joint Ventures*: This standard is to be applied by all entities that are investors with joint control of, or significant influence over, an investee.

## Key principles

- An investor controls an investee when the former is exposed to, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.
- Only substantive rights are considered while assessing whether an investor controls the relevant activities.
- An associate is an entity over which the investor has significant influence which is the power to participate in the financial and operating policy decisions of the investee but is neither control nor joint control of those policies.
- There is a rebuttable presumption of significant influence if an entity holds, directly or indirectly (e.g. through subsidiaries), 20 per cent or more of the voting power of the investee.
- A joint arrangement is an arrangement over which two or more parties have joint control. There are two types of joint arrangements- a joint operation and joint venture.
- Non-Controlling Interests (NCI) in subsidiaries is required to present in the consolidated balance sheet within equity, separately from the equity of the owners of the parent.
- Losses relating to subsidiaries have to be attributed to NCI, even if it results in a negative balance.
- A limited exemption from consolidation is available to an investment entity, which is not required to consolidate its subsidiaries if it measures all of its subsidiaries at Fair Value Through Profit or Loss (FVTPL) in accordance with Ind AS 109, *Financial Instruments*.



### Significant differences from IFRS<sup>1</sup>

- IAS 28, *Investment in Associates and Joint Ventures*, requires that for the purpose of applying equity method of accounting in the preparation of investor's financial statements, uniform accounting policies should be used. In other words, if the associate's accounting policies are different from those of the investor, the investor should change the financial statements of the associate by using the same accounting policies.
- In Ind AS 28, the phrase, 'unless impracticable to do so' has been added in the relevant requirements. This has been done, since certain associates, for example, Regional Rural Banks (RRBs), being associates of nationalised banks, are not in a position to use the Ind AS as these may be too advanced for RRBs.
- IAS 28 requires any excess of the investor's share of net assets in an associate over the acquisition cost to be recognised as a gain in the profit and loss account. Ind AS 28 requires such gain to be recognised as a capital reserve.

### Practical implications arising out of ITFG clarifications

#### Principle of control as per Ind AS 110 to be applied

Control definition as per Ind AS 110 would be applied to assess whether an investor controls another entity. In a certain case, an entity did not consolidate a subsidiary under AS 21, *Consolidated Financial Statements*, under previous GAAP, when control was intended to be temporary or there were severe long term restrictions that impair the ability to transfer funds in the near future. However, Ind AS 110 does not provide exemption from consolidation due to temporary control or severe long

term restrictions. An entity is required to consolidate all its subsidiaries unless they meet the specific exemption from consolidation (i.e. meets the recognition criteria of an investment entity). (*ITFG 5, Issue 1*)

Therefore, in order to apply Ind AS to a group, the above clarification requires relationships between entities (as holding/subsidiaries/joint ventures/associates of an entity) to be assessed on the basis of relevant Ind AS regardless of the status of such entity under previous GAAP. An entity that falls within the Ind AS road map would be required to perform a detailed and careful assessment based on its interests in/relationships with other entities. These interests may be in the form of investment in equity instruments, representation on board of directors, interest in unstructured or special purpose vehicle, participating rights held under shareholder's agreements etc. This exercise may involve significant time and efforts for some companies.

#### Consider potential voting rights while assessing whether an investment meets the criteria of an associate

In a certain situation, an entity (say A Ltd.), which invested say, 26 per cent in another entity B Ltd. and accounted it as an associate for statutory reporting requirements under previous GAAP. Another entity C Ltd. owned share warrants that were convertible into equity shares of B Ltd. and had potential, if exercised, to give additional voting power to C Ltd. over the financial and operating policies of B Ltd.

The definitions given in Ind AS would be applied both for the purpose of preparing financial statements and determining the relationship with another entity (i.e. subsidiary, associate, joint venture, etc.)

Therefore, in this case, on application of Ind AS, potential voting rights owned by C Ltd., would be considered to determine whether B Ltd. meets the criteria as an associate of C Ltd. (*ITFG 3, Issue 5*)

Additionally, A Ltd, would also need to evaluate if B Ltd., meets the criteria for recognition as an associate in accordance with the principles of Ind AS.

1. Source: ICAI's publication Indian Accounting Standards (Ind AS) : An Overview (Revised September 2017)

### Section 8 companies to prepare Ind AS financial statements if covered under road map

The companies covered under section 8 of the 2013 Act, would be required to prepare Ind AS financial statements unless and until any exemption is provided. (*ITFG 6, Issue 2*)

Consequently, Section 8 companies would be considered to be covered in the Ind AS road map, if they meet the specified criteria themselves or are subsidiaries, associates or joint ventures of an entity that is covered by the Ind AS road map.

### Consolidation of non-corporate entities

In a certain situation, a company (that is covered in the Ind AS road map) has an investment in a non-corporate entity, for example, a partnership firm. If the partnership firm qualifies as a subsidiary/joint venture/associate of the concerned company, then though Ind AS is not applicable to partnership firms, but, for the purpose of consolidation, the partnership firm would be required to provide financial statements data prepared as per Ind AS to the company. (*ITFG 11, Issue 7*)

This means that not only an entity that falls within the Ind AS road map would be required to perform a detailed and careful assessment based on its interests in/relationships with other entities as these entities too (e.g. non-corporate entities) would be required to put in dual financial information systems. This exercise may involve significant time and efforts for some companies/entities.

### Accounting for accumulated losses of subsidiaries

A subsidiary of an entity, may have incurred losses and such losses may exceed the minority interest in the equity of the subsidiary. Under AS 21, the excess, and any further losses applicable to the minority are adjusted against the majority interest except to the extent that the minority has a binding obligation to, and is able to, make good the losses.

Under Ind AS 110, entities are required to attribute the total comprehensive income of their subsidiaries to the owners of the parent and to the NCI (even if this results in the NCI having a deficit balance).

An entity may have multiple subsidiaries and could have a negative net worth as on 31 March 2015. When such a group transitions to Ind AS, then the allocation of accumulated losses of the subsidiaries will take place in

the following manner:

- *Past business combinations not restated on transition to Ind AS:* In this case, the entity will be required to attribute the total profit or loss and each component of Other Comprehensive Income (OCI) to the owners of the parent and to the NCI prospectively from the date of transition.
- *Past business combinations restated on transition to Ind AS:* In this case, the entity should attribute the accumulated losses of the subsidiaries to the owners of the parent and to the NCI from the date of application of Ind AS 103, *Business Combinations*, in its CFS, on the date of transition. (*ITFG 8, Issue 6*)

### Uniform accounting policies vs uniform accounting estimates

For further discussion on the topic, please refer Chapter 10 on Other topics- Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*. (*ITFG 11, Issue 6*)

### Treatment of intra-group profit in the CFS and previous GAAP deemed cost exemption

In a certain situation, an associate entity was accounted under the equity method in the CFS of the parent under previous GAAP. However, due to principles of defacto control in accordance with Ind AS 110, the above associate became a subsidiary. Before transition to Ind AS, the parent had sold some goods (which represented Property, Plant and Equipment (PPE) in the subsidiary) at a profit margin.

At the time of transition, assume that the parent entity opted to apply the deemed cost exemption as provided under paragraph D7AA of Ind AS 101, *First Time Adoption of Indian Accounting Standards*. In accordance with guidance given in the above paragraph D7AA of Ind AS 101, a first-time adopter to Ind AS may elect to continue with the carrying value for all of its PPE as per the previous GAAP and use that as its deemed cost as at the date of transition after making necessary consequential adjustments permitted under Ind AS.

Ind AS 101 further provides that in the CFS, the previous GAAP amount of the subsidiary should be the amount used in preparing and presenting CFS.



Where a subsidiary was not consolidated under previous GAAP, the amount required to be reported by the subsidiary as per previous GAAP in its individual financial statements shall be the previous GAAP amount.

Additionally, Ind AS 110 requires full elimination of intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group (profits or losses resulting from intra group transactions that are recognised in assets such as inventory and PPE are eliminated in full).

In this case, such unrealised profit existing in the PPE would require elimination in the CFS. Therefore, the parent would first eliminate the intra group profit recognised in SFS of the subsidiary since Ind AS 110 requires full elimination of intra-group profits or losses.

Subsequent to the elimination of intra-group profit in the SFS of its subsidiary, the parent may apply the deemed cost exemption under paragraph D7AA of Ind AS 101. (ITFG 12, Issue 5)

### Disclosures in situation involving dilution of stake in a subsidiary

A situation may arise involving a parent and its subsidiary where the stake of parent gets reduced (though there is no loss of control of the parent on its subsidiary) on account of infusion of additional funds in the subsidiary by another investor.

In accordance with the guidance provided in Ind AS 110, changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions (i.e. transactions with owners in their capacity as owners). Thus, such transactions have no impact on goodwill or the statement of profit and loss.

Additionally, in accordance with Appendix B to Ind AS 110, when the proportion of the equity held by NCI changes, an entity is required to adjust the carrying amounts of the controlling entity investor and NCI to reflect the changes in their relative interests in the subsidiary. The entity shall recognise directly in equity any difference between the amount by which the NCI are adjusted and the fair value of the consideration paid or received, and attribute it to the owners of the parent.

Moreover, at the time of initial recognition i.e. at the date of business combination, NCI are recorded at fair value (or proportionate share in the recognised amounts of the acquiree's identifiable net assets, if so chosen). However, subsequent purchases or sales of ownership interests when control is maintained, are recorded at the NCI's proportionate share of the net assets.

Therefore, the entity should provide disclosures of change in ownership interest as follows:

- *In separate financial statements:* As there is no impact on the investment in the subsidiary, it may continue to be disclosed at its carrying amount in the SFS of the parent. However, as there is a reduction in the shareholding of the parent in the subsidiary is required then this fact should be disclosed in the SFS of the parent even though there is no loss of control. This is an additional disclosure to be made in the financial statements.
- *In consolidated financial statements:* In accordance with the specific requirements contained in Ind AS 112, *Disclosure of Interests in Other Entities*, an entity is required to present a schedule that shows the effects on the equity attributable to owners of the parent of any changes in its ownership interest in a subsidiary that do not result in a loss of control. (ITFG 13, Issue 7)



# Ind AS 103, Business Combinations (including common control transactions)



## Key principles

- Ind AS 103 provides guidance on accounting for business combinations under the acquisition method. A business combination is a transaction or other event in which a reporting entity (the acquirer) obtains control of one or more businesses (the acquiree). The date of acquisition is the date on which the acquirer obtains control of the acquiree.
- There are certain exceptions to acquisition accounting:
  - Formation of a joint arrangement
  - Acquisition of an asset or a group of assets that does not constitute a business
  - Acquisition of an investment in a subsidiary that is required to be measured at FVTPL by an investment entity.
- A 'business' is an integrated set of activities and assets that are capable of being conducted and managed to provide a return to investors by way of dividends, lower costs or other economic benefits.
- The identifiable assets acquired and the liabilities assumed are measured at the date of acquisition at their fair values, with limited exceptions.
- The acquirer should measure the components of NCI in the acquiree that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation at fair value or the present ownership instruments' proportionate share in the recognised amounts of the acquiree's identifiable net assets, at the acquisition date.
- All other components of NCI (such as equity components of convertible bonds under share based payments arrangements) should be measured at fair value in accordance with other relevant Ind ASs.

## Assets and liabilities (other than goodwill)

- The identifiable assets acquired and the liabilities assumed are recognised separately from goodwill at the date of acquisition if they meet the definition of assets and liabilities and are exchanged as part of the business combinations.
- Consideration transferred is required to be measured at fair value, which is calculated as the sum of the acquisition-date fair values of the assets transferred by the acquirer, the liabilities incurred by the acquirer to former owners of the acquiree and the equity interests issued by the acquirer.
- An obligation to pay contingent consideration that meets the definition of a financial instrument should be recognised as a financial liability or as equity in accordance with Ind AS 32, *Financial Instruments: Presentation*.

### Acquisition related costs

- Acquisition related costs are costs which an acquirer incurs to effect a business combination and are excluded from the consideration transferred and expensed when incurred except costs to issue debt or equity securities which are to be recognised in accordance with Ind AS 32 and Ind AS 109, *Financial Instruments*.

### Goodwill or a gain from a bargain purchase

- Goodwill is measured as the difference between the consideration transferred in exchange for the net of the acquisition date amounts of the identifiable assets acquired and the liabilities assumed. Goodwill previously recorded by the acquiree is not recorded as a separate asset by the acquirer.
- In case of bargain purchase (i.e. the amount of identifiable assets acquired and the liabilities assumed exceeds the amount of consideration transferred), the amount of gain should be recognised in OCI on the acquisition date and accumulated in equity as capital reserve after reassessing the values used in the acquisition accounting.

### Business combinations of entities under common control

- Common control business combination means a business combination involving entities or businesses in which all the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory.
- Common control business combinations should be accounted for using the pooling of interests method.

### Significant differences from IFRS<sup>2</sup>

- IFRS 3, *Business Combinations* excludes from its scope business combinations of entities under common control. Ind AS 103 (Appendix C) provides guidance in this regard.
- IFRS 3 requires bargain purchase gain arising on business combination to be recognised in the statement of profit and loss. Ind AS 103 requires that the bargain purchase gain should be recognised in OCI and accumulated in equity as capital reserve, unless there is no clear evidence for the underlying reason for classification of the business combination as a bargain purchase, in which case, it should be recognised directly in equity as capital reserve.

### Practical implications arising out of ITFG clarifications

#### Accounting for common control transactions

Under IFRS, there is limited authoritative guidance on accounting for legal mergers or common control business combinations. However, internationally practices<sup>3</sup> have developed where it is acceptable<sup>4</sup> to choose an accounting policy (to be applied consistently) to determine values of assets and liabilities of the acquiree entity. The acquirer in a common control transaction can use either of the following in its CFS:

- Book value (carry-over basis) accounting on the basis that the investment has simply been moved from one part of the group to another, or
- IFRS 3 accounting on the basis that the acquirer is a separate entity in its own right and should not be confused with the economic group as a whole.

2. Source: ICAI publication Indian Accounting Standards (Ind AS): An overview (Revised September 2017)

3. Source: KPMG IFRG Limited's publication: Insights into IFRS 14<sup>th</sup> Edition

4. Based on the facts and circumstances of each case and depending upon the nature of the common control transactions.

In applying book value accounting, the acquirer should choose an accounting policy to be applied consistently, in recognising the assets and liabilities assumed using book values in the financial statements of the following entities:

- Transferor entity
- Ultimate parent
- Entity transferred, or
- Intermediate parent (if any).

However, for preparing financial statements, the accounting clarifications of the ITFG restrict Indian companies to the approaches laid down as follows:

- *Situation 1 - Merger of two fellow subsidiaries:* An entity merges with its fellow subsidiary (i.e. another entity with the same parent entity). Appendix C of Ind AS 103 provides that the assets and liabilities of the combining entities are reflected at their carrying amounts. Accordingly, post-merger, the SFS of the merged entity would reflect combination of the carrying amounts of assets and liabilities reflected in the SFS of the entities (as appearing in their respective SFS.)
- *Situation 2 - Merger of subsidiary with its parent:* An entity merges with its parent entity. In such a case, nothing changes and the transaction only means that the assets, liabilities and reserves of the subsidiary which were appearing in the CFS of the group immediately before the merger, would now be a part of the SFS of the merged parent entity. The SFS of the parent entity (to the extent of such a common control transaction) would be considered as a continuation of the consolidated group. Accordingly, it would be appropriate to recognise the carrying value of assets, liabilities and reserves pertaining to the combining subsidiary, as appearing in the CFS of the parent entity.

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, all intra-group transactions should be eliminated in preparing CFS. Hence, in both the given situations, the effect of legal merger should be eliminated while preparing the CFS of the parent entity. (*ITFG 9, Issue 2*)

Accordingly, companies who are contemplating a restructuring or are in the process of completing a restructuring may have to evaluate the impact of clarification on their respective financial statements.

### **Acquisition date in a scheme approved by National Company Law Tribunal (NCLT)**

Ind AS 103 requires an acquirer to identify the acquisition date which is the date on which it obtains control of the acquiree. Such a date is generally the closing date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree. However, an acquirer could obtain control on a date earlier or later than the closing date (e.g. a written agreement provides that the acquirer obtains control of the acquiree on a date before closing date). An acquirer should consider all relevant facts and circumstances in making this assessment.

In accordance with the provisions of the 2013 Act (proviso to Section 232(3)), no scheme of arrangement would be sanctioned by the NCLT unless a certificate by the company's auditor has been filed with the NCLT. The certificate should comment on the effect of the accounting treatment, if any, proposed in the scheme of compromise or arrangement and specify whether it is in conformity with the accounting standards prescribed under Section 133 of the 2013 Act.

In a situation pursuant to a court scheme, a company is merged with another company with an appointed date approved by NCLT. In this case the appointed date was prior to Ind AS implementation date for the company.

Ind AS 103 requires that an entity is first required to assess whether the business combination is under common control. Therefore, the accounting treatment would depend on following scenarios:

*Business combination is under common control:* In such a case, an entity is required to restate its financial statements as if the business combination had occurred from the beginning of the preceding period in the financial statements.

If an auditor considers that as per the proposed accounting treatment, the date from which the amalgamation is effected in the books of accounts of the amalgamated company is different from the acquisition date as per Ind AS 103 i.e. the date on which control has been actually transferred, then the auditor should state the same in the certificate to be issued under Section 232(3) of the 2013 Act.

Additionally, if the NCLT approves the scheme with a different appointed date as compared to the acquisition date as per Ind AS 103, then the appointed date approved by the NCLT would be considered as the acquisition date for business combinations. The company would be required to provide appropriate disclosures and the auditor would need to consider the requirements of relevant auditing standards when issuing its certificate. (*ITFG 12, Issue 8*)

*Business combination is not under common control:*  
In such a case, Ind AS 103 provides that the date of acquisition is the date from which an acquirer obtains control of the acquiree.

In cases where the auditor is of the view that as per the proposed accounting treatment, the date from which the amalgamation is effected in the books of accounts of the amalgamated company is different from the acquisition date as per the standard i.e., the date on which control has been actually transferred, then the auditor should state the same in the certificate as required to be issued as per the proviso to Section 232(3) of the 2013 Act. However, if the NCLT approves the scheme with a different appointed date as compared to the acquisition date as per Ind AS 103, the appointed date as approved by NCLT under the scheme will be the acquisition date. In this situation, the company should provide appropriate disclosures and the auditor should consider the requirements of relevant auditing standards. (*ITFG 12, Issue 8*)

This clarification is likely to have a significant impact since the approved appointed date could differ from the acquisition date as determined under Ind AS 103. Therefore, the accounting treatment based on the appointed date being considered as the acquisition date may not be in accordance with Ind AS 103. Companies should consider the impact of this clarification on their schemes and determine the appropriate disclosure to be made in their financial statements if the appointed date approved by the NCLT is different from the acquisition date under Ind AS 103. Further, auditors may consider the requirements of relevant auditing standards in their certificates to be issued under the 2013 Act.

### **Business combination after the year end but before approval of accounts to be considered an adjusting event**

In a situation, two fellow subsidiaries (i.e. entities under common control), which are covered under phase I of Ind AS road map, filed a scheme of arrangement in April

2017 for merger of one fellow subsidiary (say entity X, transferor) into another entity (say entity Y, which is the transferee in this case).

In accordance with the requirements of Section 230(7) of the 2013 Act, the auditor's certificate states that the accounting treatment proposed in the scheme of compromise or arrangement is in conformity with the Ind AS. The certificate was filed with NCLT by the entity X. The NCLT approved the scheme with an appointed date of 1 April 2018 (i.e. after the close of financial year on 31 March 2018 but before the approval of financial statements by the Board of Directors).

Ind AS 10, *Events After the Reporting Period*, provides that events after the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are approved by the Board of Directors in case of a company, and, by the corresponding approving authority in case of any other entity for issue. Two types of events can be identified:

- Those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period) and
- Those that are indicative of conditions that arose after the reporting period (non-adjusting events after the reporting period).

In addition, Ind AS 10 provides that a major business combination after the reporting period is a non-adjusting event.

However, in this case, since the court order approved a scheme with a retrospective effect subsequent to the balance sheet date but before the approval of financial statements, the effective date for accounting is prior to the balance sheet date.

In this case, the court's approval is an event that provides additional evidence to assist the estimation of amounts of assets and liabilities that existed at the balance sheet date. Therefore, an adjusting event has occurred which requires adjustment to the assets and liabilities of the transferor entity which are being transferred.

Therefore, the effect of business combination of entity X and entity Y is required to be incorporated in the SFS of entity Y for the financial year ending on 31 March 2018. (*ITFG 14, Issue 4*)

# Financial Instruments



Transactions in financial instruments are pervasive across many entities in India. While there was no specific Accounting Standard (AS) covering financial instruments, under the Ind AS framework the following standards provide detailed guidance on accounting for financial instruments:

- Ind AS 32, *Financial Instruments: Presentation*: This standard establishes principles for an issuer to classify and present financial instruments as a financial liability or an equity instrument, and classify the related interest, dividends, losses and gains. It also prescribes the circumstances in which financial instruments may be offset and presented net on the balance sheet.
- Ind AS 109, *Financial Instruments*: This standard specifies the recognition, classification and measurement criteria for financial assets and financial liabilities and
- Ind AS 107, *Financial Instruments: Disclosures*: This standard prescribes the disclosure requirements for all transactions in financial instruments.

(These are collectively called as 'the standards'.)

## Key principles

- Financial instruments that give rise to a contractual obligation to deliver cash or another financial asset are classified as financial liabilities and those instruments
- Financial assets measured at amortised cost and at FVOCI are assessed for impairment at each reporting date, using an expected credit loss model.

that encompass a residual interest in the assets of an entity are classified as equity. Instruments may also have a component of both - liability and equity, these components will be classified and presented separately.

- Puttable instruments are generally classified as financial liabilities, however, the standards specify the conditions under which these can be considered as 'equity'.
- Interest, dividends, losses and gains on financial instruments or their components are recorded either in the statement of profit and loss or in OCI, depending upon the classification of the related instrument as financial liability or equity.
- Financial assets are classified on initial recognition and subsequently measured at amortised cost, Fair Value through Profit or Loss (FVTPL) or Fair Value through Other Comprehensive Income (FVOCI), depending upon the business model within which they are held and the contractual cash flows of the instrument (i.e. whether the contractual cash flows are solely in the nature of principle and interest on the principal amount outstanding).



- A modification in the terms of financial instruments may result in their derecognition. The standards prescribe accounting for such modifications, and the conditions that would result in derecognition.
- Hybrid contracts may be treated as a single financial instrument measured at FVTPL, or under certain specified conditions, embedded derivatives may be separated from the host contract, and accounted for separately.
- All derivatives are generally classified as and measured at FVTPL, with mark-to-market gains and losses being recognised in the statement of profit and loss. However, those derivatives that qualify as hedging instruments and are designated in a hedging relationship, are treated in accordance with the hedge accounting principles prescribed by the standards.
- The hedge accounting principles permit excluding the time value of options, forward element of forward contracts, and foreign currency basis spread of currency swaps from the designated hedging instrument. These components may be separately recognised as a 'cost of hedging'.
- Financial assets and financial liabilities are required to be presented on a gross basis. However, an entity may offset these and present them as a net amount only if it has a legal right, and intends to settle both, the asset and liability simultaneously.

Adequate disclosure of financial instruments and related risks are imperative to reflect an entity's financial position and performance, the nature and extent of risks that it is exposed to, and the manner in which it manages those risks. Accordingly, entities are required to provide quantitative and qualitative disclosures for exposure to financial instruments and financial risks, including liquidity risk, credit risk and market risk (which includes currency risk, interest rate risk and other price risks).

### Significant difference from IFRS<sup>5</sup>

#### Ind AS 32 compared with IAS 32, *Financial Instruments: Presentation*

IFRS requires an equity conversion option that is embedded in a foreign currency convertible bond, to be recognised as a financial liability at inception as the conversion price is fixed in foreign currency and not in the entity's functional currency. Hence, it does not result in an exchange of a fixed amount of cash (in the entity's functional currency) for a fixed number of shares. Therefore, the conversion option would not be classified as equity under IFRS. However, Ind AS provides a specific exemption in the definition of a financial liability and states that an exchange of a fixed number of shares for a fixed amount of cash in any currency would result in a derivative financial instrument being classified as equity.

### Practical implications arising out of ITFG clarifications

#### Scope

Ind AS 32 defines a financial instrument as a contract that gives rise to a financial asset of one entity and a financial liability or an equity instrument of another entity. Ind AS 109 applies to all types of financial instruments, however, it has certain exceptions.

'Investments in shares of other entities' meet the definition of financial instruments, accordingly, these will be recognised and measured in accordance with Ind AS 109, presented as per the requirements of Ind AS 32 and disclosed as per the principles enunciated in Ind AS 107.

5. Source: ICAI's publication Indian Accounting Standards (Ind AS): An Overview (Revised September 2017)

The ITFG clarified that shares held by a broking entity for trading on its own account (as stock-in-trade) are financial instruments, and are specifically excluded from the scope of Ind AS 2, *Inventories*. Accordingly, these shares will be accounted for and disclosed in accordance with the requirements of Ind AS 32, 109 and 107. (*ITFG 14, Issue 5*)

### Financial guarantee contracts

Ind AS 109 defines a financial guarantee contract as one that requires the issuer to make specified payments to reimburse the holder for a loss that it incurs because a specified debtor fails to make payment when it is due in accordance with original or modified terms of a debt instrument.

#### Legal form

Financial guarantee contracts can have various legal forms. These may include a comfort letter, on the basis of which a credit holder receives a bank loan, as long as the significant feature of the instrument is the contractual obligation to make specified payments in case of default by the credit holder. (*ITFG 12, Issue 3*)

#### Accounting

##### A. By the issuer

As per Ind AS 109, on initial recognition financial guarantee contracts are recognised at their fair value. The fair value of a financial guarantee contract issued in a stand-alone arm's length transaction to an unrelated party is likely to equal the premium received. Where no up-front payment of premium is made between unrelated parties, the fair value is likely to be zero. Subsequently, the financial guarantee contract is measured at the higher of the amount of loss allowance (estimate of the expected loss that would devolve on the guarantee contract) and the amount initially recognised less cumulative amount of income recognised in accordance with Ind AS 18, *Revenue*.

Where an entity provides a financial guarantee against a loan taken by its associate entity, and receives a guarantee commission from the associate, it should account for the contract in the following manner:

- **Initial measurement:** The entity needs to determine whether the commission is equivalent to the premium that its associate entity would pay to obtain a similar guarantee in a stand-alone arm's length transaction. If so, then, on initial recognition, the fair value of the financial guarantee contract is likely to equal the commission received.

- **Subsequent measurement:** Financial guarantee contracts should subsequently be measured in accordance with Ind AS 109 as stated above. (*ITFG 12, Issue 11*)

As per Ind AS 109, the parent is required to recognise a liability in its SFS for the fair value of the guarantee provided. This is irrespective of the fact that no consideration may be received by the parent, or the consideration is not equivalent to the premium that the associate entity would pay to obtain a similar guarantee in a stand-alone arm's length transaction.

Where no commission is paid by the associate entity (or where the payments are not equivalent to the fair value of the financial guarantee contract), the parent entity may consider that the guarantee has been provided in its capacity as a shareholder. Consequently, the fair value of the guarantee (or the difference between the fair value and the payments received from the associate) would be considered as a capital contribution to the associate.

##### B. By the beneficiary

Ind AS 109 does not specifically address the accounting for financial guarantees by the beneficiary. However, in an arm's-length transaction between unrelated parties, the beneficiary of the financial guarantee would recognise the guarantee premium or fee paid as an expense in its statement of profit and loss.

Where a director of the beneficiary company has issued a financial guarantee in favour of a bank, which has provided a loan to the company, the beneficiary company would be required to assess the substance of the transaction, taking relevant facts and circumstances into consideration, to determine the accounting treatment as follows:

- **Guarantee fee:** If the company has paid a guarantee fee or a premium to the director for the guarantee provided, it would account for such fee in accordance with Ind AS 109.
- **Other compensation:** Where the director is being compensated otherwise for providing the guarantee, an appropriate accounting treatment based on the principles of the relevant Ind AS would be followed to recognise such compensation.

Therefore, if no fee has been paid to the director (or other related party), and such party is not being compensated in any other manner, the company is not required to account for such a financial guarantee in its financial statements considering that the unit of account is the guaranteed loan. The loan is recognised at its fair value that is expected to be the face value of the loan proceeds received by the company. However, this transaction needs to be evaluated for disclosure under Ind AS 24, *Related Party Disclosures* which requires disclosure of any guarantees given to or received from related parties. (ITFG 13, Issue 2)

A similar scenario may involve a parent entity providing a financial guarantee to a bank relating to a loan advanced to its subsidiary. While Ind AS 109 requires the guarantor, i.e. the parent entity to recognise the guarantee liability at its fair value, there is no specific accounting guidance relating to a situation where the subsidiary does not pay any guarantee fee or premium to the parent entity. In this case, we consider that this is akin to a deemed capital contribution by the parent to its subsidiary and should be recognised as an additional investment in the subsidiary.

Ind AS 109 does not provide any specific guidance relating to the impact of such financial guarantee contracts in the SFS of the beneficiary, i.e. the subsidiary.

### Debt-equity classification

As per Ind AS 32, financial instruments or their components are classified as a financial liability or equity in accordance with the substance of the contractual arrangement. Instruments are classified as a financial liability if they include a contractual obligation to deliver cash or other financial assets. Equity instruments on the other hand, evidence a residual interest in the assets of the entity after deducting all its liabilities. Financial instruments or their components that are in the nature of derivatives that may be settled in the issuer's own equity instruments, would be classified as equity, only if the terms of the instrument require an exchange of a fixed amount of cash or other financial assets for a fixed number of the issuers own equity instruments (known as the 'fixed for fixed' criterion).

#### Classification as debt or equity

The primary factor determining the classification of a financial instrument either as a financial liability or equity,

is whether the entity that has issued the instrument, has a contractual obligation to make payments (either principal, interest/dividend or both)/has the contractual right to avoid making such payment.

In this context, ITFG considered the accounting for a non-cumulative, optionally convertible preference share issued by a company (S) to its holding company (H). As per the terms of issue, S has the option to convert or redeem the stated preference shares. Assuming that S has an option to convert the preference shares into a fixed number of its own shares, and dividend payment is discretionary, the accounting for the instrument will be as follows:

- *In the SFS of S:* While assessing the classification of the preference shares in its standalone financial statements, S assesses that:
  - The terms of the instrument provide it with the ability to avoid making cash payment (of the dividend as well as of the principal), and convert the instrument into a fixed number of its own shares at any time
  - The conversion option is already considered in determining the classification of the entire instrument, and hence is not accounted for separately as an embedded derivative and
  - Discretionary payment features (such as discretionary dividend) on equity instruments are considered as an integral component of the instrument.

Considering these facts, the entire instrument would be classified as equity in the SFS of S.

- *In the SFS of H:* Ind AS 27, *Separate Financial Statements*, provides entities with an accounting policy choice to account for their investments in subsidiaries, joint ventures and associates in their standalone financial statements, either at cost or in accordance with Ind AS 109. Assuming that H has not chosen to account for its investment in accordance with Ind AS 109, it would account for it at cost.
- *In the CFS:* These transactions, being intra-group transactions, would be eliminated in accordance with Ind AS 110. (ITFG 14, Issue 7)

While assessing the contractual rights associated with the instrument, it is imperative to determine whether these rights are substantive. This is required to be done when initially assessing the classification of the instrument. In some cases, the contractual right to settle the instrument by delivering a fixed number of shares may not be substantive, resulting in the instrument to establish a contractual obligation to deliver a variable number of shares/make cash payments indirectly through its terms and conditions. For example, if on initial recognition of the instrument, S determines that the market value of its shares substantially exceeds the amount of cash payment. In this case, although S does not have an explicit contractual obligation to settle in cash, the value of the share settlement option is so high, that S would always settle in cash.

#### *Measurement of compound financial instrument*

A financial instrument may contain both a liability and an equity component – these are known as compound financial instruments. For example, compulsorily convertible debentures with a mandatory coupon, issued for a period of 10 years, convertible into a fixed number of shares at the end of their term are in the nature of a compound instrument. Entities are required to follow ‘split accounting’ for such instruments, by separately classifying and recognising the liability (mandatory coupon payable at a fixed interest rate) and equity components (principal component convertible into a fixed number of equity shares).

While measuring the liability and equity components, the entity first determines the fair value of the liability component (assuming there is no embedded derivative) by computing the present value of the contractually determined stream of future cash flows. These cash flows are discounted at the rate of interest applied at that time by the market to instruments of comparable credit status and providing substantially the same cash flows, on the same terms, but without the conversion option (in this case it would be computed by discounting the interest cash outflows on the compulsorily convertible debentures for 10 years at the incremental borrowing rate applicable to the entity for a comparable 10 year loan).

The equity component would be measured at the residual amount, after deducting the fair value of the financial liability component from the fair value of the entire compound instrument. (*ITFG 13, Issue 10*)

### **Classification and measurement of financial instruments**

On initial recognition, Ind AS 109 requires entities to classify financial assets into the amortised cost, FVOCI or at FVTPL categories based on the business model within which they are held and the nature of their contractual cash flows. The classification determines the basis on which such financial assets are subsequently measured. Entities may hold financial assets within a business model, which has an objective to either:

- Hold assets in order to collect contractual cash flows ('held to collect')
- Both collect contractual cash flows and sell financial assets ('held to collect and for sale'), or
- Hold assets for sale ('held for sale').

Financial assets held within a 'held to collect' business model are generally managed by collecting the cash flows generated by the asset over its life. However, Ind AS 109 clarifies that entities need not hold all instruments until maturity. Thus, it becomes necessary to consider the frequency, value and timing of sales in prior periods, and expectations about future sales activities when assessing the business model. In this context, Ind AS 109 states that sales of instruments could be consistent with a 'held to collect' business model if they are infrequent (though significant in value) or are insignificant in value both individually and in aggregate (even if frequent). Ind AS 109, however, does not define 'infrequent' or 'insignificant'.

It has been clarified that there is no 'rule of thumb' in terms of an indicative percentage to determine 'infrequent number of sales' or sales that are 'insignificant in value', considering the differing quantum, configuration and nature of financial assets in various entities. Management should, therefore, exercise judgement and establish criteria to identify situations in which sales of financial assets occurring before maturity may be consistent with a 'held to collect' business model. (*Frequently Asked Questions (FAQs) issued by ICAI on elaboration of terms used in Ind AS 109*)

### **Interest, dividends, losses and gains on financial instruments**

Ind AS 32 requires interest, dividends, losses and gains on financial instruments to be recognised either in the statement of profit and loss or in equity, depending on the classification of the financial instruments or components of financial instruments to which they pertain.

### Dividends on financial liabilities

As per Ind AS 32, dividends paid on financial instruments that are classified as financial liabilities, would be presented as 'interest expense', and accounted for accordingly.

Ind AS 10, *Events after the Reporting Period* states that when entities declare dividends to holders of equity instruments after the reporting period, they should not recognise a liability for those dividends at the end of the reporting period.

Dividend/interest on financial instruments or components classified as liabilities are 'interest expenses', and hence, should accrue at the end of the reporting period, irrespective of when the dividend is declared (even after the reporting period) or paid. If the liability is classified and subsequently measured at amortised cost, the dividend/interest would be computed using the Effective Interest Rate (EIR) method and debited to interest expense (in the statement of profit and loss). (*ITFG 7, Issue 6*)

Discretionary dividends paid on a compound instrument, i.e. an instrument that is partly equity in nature, may relate to the equity component of the instrument. In this scenario, it needs to be considered that the issuer would generally recognise these as dividends on the equity component of the instrument, i.e. subject to declaration, and would not accrue for these dividends as an interest expense.

### Dividend distribution taxes

Ind AS 12, *Income Taxes* requires entities to pay a portion of the dividends payable to shareholders, to the taxation authorities on behalf of shareholders as Dividend Distribution Tax (DDT).

It has been clarified that DDT payable by companies in India are in the nature of withholding taxes and requires their presentation to be consistent with the presentation of the transaction that created those income tax consequences. Therefore, the presentation of dividend and DDT in an entity's stand-alone financial statements would be as follows:

- *Financial instruments classified as debt:* Dividend on the financial instruments and DDT thereon should be charged to the statement of profit and loss.
- *Financial instrument classified as equity:* Dividend on the financial instruments and DDT thereon should be recognised in equity and presented in the statement of changes in equity.
- *Compound financial instrument:* Dividend allocated to the debt portion of the instrument and DDT thereon should be charged to the statement of profit and loss and dividend allocated to the equity portion of the instrument and the DDT thereon should be recognised in equity. (*FAQ issued by ICAI*)

### Recognition of interest income

Ind AS 109 requires interest revenue on financial assets at amortised cost or FVOCI (investments in debt instruments) to be computed using the EIR method, wherein the EIR<sup>6</sup> is applied to the gross carrying amount of a financial asset, except in certain circumstances.

Dividend income on an investment in a debt instrument would be recognised in the form of 'interest income' by an investor. However, the manner in which income would be computed and recognised would depend on the classification and measurement category of the investment in a debt instrument, as determined as per Ind AS 109. This is further explained below:

- *Debt instrument is subsequently measured at amortised cost:* The interest income is computed by applying the EIR to the gross carrying amount of the financial asset, when the instrument is not 'credit-impaired'. Instruments are said to be credit impaired if they are unable to meet their financial contractual obligations due to detrimental cash flows. Interest income on such assets is computed in the manner specified below:
  - Where the asset was credit-impaired on its purchase or on origination: Interest income is computed on such assets by applying the credit adjusted EIR to the amortised cost of the financial asset
  - Where the asset has subsequently become credit impaired: Interest is computed by applying EIR to the amortised cost of the financial asset during the period that the asset is considered as credit impaired. When the credit risk improves so that the financial asset is no longer credit impaired, interest income is computed by applying the EIR to its gross carrying amount.
- *Debt instrument is classified and measured at FVOCI:* Interest income is recognised in the statement of profit and loss in accordance with the EIR method.

6. EIR is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability. It is used to compute the gross carrying amount of financial assets or the amortised cost of financial liabilities.



- *Debt instrument is classified and measured at FVTPL:* Interest income is generally presented as part of the fair value gains or losses on the instrument or may be presented separately in the statement of profit and loss. An entity is required to disclose its accounting policy on this aspect in its financial statements. (ITFG 8, Issue 9)

### Effective interest rate - Transaction costs

On initial recognition of an instrument, Ind AS 109 requires entities to identify transaction costs and fees that are an integral part of the EIR of such instruments. These transaction costs and fees (such as origination and processing fees) are treated as an adjustment to the EIR, and are amortised over the expected life of the instrument.

(Please refer Chapter 10 on Other topics - Borrowing Costs for more details on capitalisation of DDT paid on preference shares dividend and processing charges to the cost of qualifying asset) (ITFG 13, Issue 1 and ITFG 14, Issue 1)

### Undisbursed loans

Processing fees paid relating to term loans are in the nature of origination fees and are adjusted in the EIR of the term loan. However, where the loan is drawn down in tranches, processing fees need to be evaluated for each tranche separately. Accordingly, for undisbursed term loans, the processing fees should be accounted for as follows:

- *Where it is probable that the undisbursed term loan will be drawn down in the future:* The processing fee pertaining to the loan should be considered as a transaction cost under Ind AS 109, and amortised to the statement of profit and loss over the period of the loan tranche it pertains to, when it is drawn down. Until then, the amount would be recognised as a deferred expense in the balance sheet.
- *Where it is not probable that the undisbursed portion of the term loan will be drawn down in the future:* The entire processing fee pertaining to the loan should be recognised as an expense on a straight-line basis, over the term of the loan. (ITFG 10, Issue 2)

However, further clarity may be required on the period over which the processing fee should be amortised, i.e., whether this is the remaining drawdown period or the tenor of the disbursed component of the loan.

If, on the other hand, the fees paid by the entity are in the nature of facility or commitment fees for ensuring availability of funds during the draw-down period of a loan, we consider that it may be appropriate to recognise such fees on the undrawn component as an expense over the facility commitment period. In that scenario, the fees would relate to arranging the loan facility, and are intended to compensate the bank for keeping funds available during the commitment period. This commitment period could be shorter than the term of the loan (relating to the component that may have been drawn down).

### Modification of financial instruments

The terms of financial instruments may be renegotiated, resulting in a modification in the timing and/or amount of contractual cash flows of the instrument. The modified terms need to be evaluated to ascertain the extent of modification, which would determine the accounting treatment for the transaction.

### Modification of terms

Where the modification of a financial instrument would result in revised cash flows whose timing and amount is not substantially<sup>7</sup> different from those of the original instrument, such modification would not result in derecognition of the instrument. In this case, the gross carrying amount of the instrument is recalculated by discounting the modified contractual cash flows using the original EIR. Any difference between this recalculated amount and the existing gross carrying amount (of financial assets or amortised cost of financial liabilities) is recognised in the statement of profit and loss as a modification gain or loss.

If a debt instrument is in default in a particular financial year (say year 1), and the terms of the instrument have been renegotiated in the next financial year (say year 2) (prior to approval of the financial statements), the modification gain or loss on the renegotiated debt instrument would be recognised in the financial year in which the renegotiation contractually takes place (i.e. year 2). (ITFG 13, Issue 6)

7. As per Ind AS 109, the extent of modification needs to be determined considering qualitative and quantitative factors.



### Refinancing arrangements

Where the terms of a debt instrument (say a loan) have been substantially modified, this would result in an extinguishment of the loan.

This would lead to derecognition of the original loan and recognition of the new (modified) loan, at its fair value. The difference between the amount derecognised and the fair value of the new loan is treated as a modification gain or loss and recognised in the statement of profit and loss. Expenses incurred on such modification, including transaction costs should be assessed to determine their accounting treatment.

In this context, when an entity enters into a refinancing arrangement for its old loan facility, wherein it takes a new loan to pay off its old loan facility, this arrangement is considered a modification resulting in derecognition of the old loan. Such a transaction involves various fees, including processing fees for the new loan and prepayment premium for the old loan. The accounting treatment for the transaction would be as follows:

- Original loan: The difference between the carrying amount of the original loan repaid (or extinguished) and the consideration paid on extinguishment would be recognised in the statement of profit and loss.
- Unamortised processing fees on old loan: These would be charged to the statement of profit and loss.
- Prepayment premium: Refinancing of the old loan is in the nature of a modification in the terms of the loan that would lead to derecognition. Accordingly, the prepayment fees paid by the entity would be considered as costs or fees incurred on extinguishment of the loan, and would be included as a part of gain or loss on extinguishment of the loan (in the statement of profit and loss).
- New loan processing fees: Processing fees on the new loan facility are not a modification/renewal fee. Instead, these are an integral part of originating the new loan, and would be considered as a transaction cost that is included in the computation of EIR of the new loan. (*ITFG 12, Issue 4*)

It is imperative to note that this accounting treatment may not apply to situations where the contractual terms of a loan are modified/restructured due to financial difficulties. Entities would have to analyse the relevant facts and circumstances to determine whether the modified loan should be derecognised and the consequent impact on costs and fees incurred in relation to the origination or modification of the loan.

### Hedge accounting

Ind AS 109, permits an entity to apply hedge accounting principles to its derivative transactions if it meets the qualifying criteria specified in the standard. Ind AS 109 specifies that 'a cash flow hedge is a hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with all, or a component of, a recognised asset or liability (such as all or some future interest payments on variable rate debt) or a highly probable forecast transaction, and could affect profit or loss.' In a cash flow hedge the fair value gains and losses on the derivative hedging instrument are recognised in reserves and recycled to the statement of profit and loss when the hedged item/hedged transaction affects profit or loss.

An entity that has, under paragraph D13AA of Ind AS 101, continued its previously adopted policy of capitalising foreign exchange differences on its long-term foreign currency loan will not recognise these foreign exchange differences in profit or loss. These foreign exchange differences form part of the carrying value of the related fixed asset and are depreciated over the balance useful life of the asset.

An entity that has availed of the option available under paragraph D13AA of Ind AS 101 and continues to capitalise (to the cost of the related asset) the foreign exchange differences arising from a long term foreign currency loan, has no corresponding foreign currency exposure (arising from that loan) that affects profit or loss. Accordingly, cash flow hedge accounting under Ind AS 109 would not be applicable to any foreign currency derivatives transacted to hedge the foreign currency risk of such foreign currency loans. The derivatives would therefore be considered as held for trading and any change in fair value will be recognised in profit or loss. (*ITFG 3, Issue 10*)

## Disclosure

### *Market risk disclosures for certain instruments*

As per Ind AS 107, entities are required to provide quantitative and qualitative disclosures of their exposure to various financial risks arising from financial instruments. Ind AS 107 also requires disclosure of an entity's objectives, policies and processes for managing those risks and other concentrations of risk. Additionally, with respect to market risk, in addition to disclosing the exposure to foreign currency risk, interest rate risk, and other price risk, an entity is required to provide an analysis of sensitivity to these risks. This sensitivity analysis reflects how profit or loss and equity would be affected by reasonably possible changes in the relevant risk variable at the reporting date.

Paragraph D 13AA of Ind AS 101 permits an entity to continue the policy (if selected under AS) of capitalising/ transferring to reserves the foreign exchange differences arising from translation of long term foreign currency monetary items recognised prior to the date of implementation of Ind AS. The financial risk related

disclosure requirements of Ind AS 107 would also apply to such long-term foreign currency monetary items (for which the option under paragraph D13AA of Ind AS 101 has been availed). This is because, the entity still remains exposed to foreign currency risk in respect of such instruments, and these could lead to an indirect impact in the statement of profit and loss or equity, for example through depreciation or amortisation of the capitalised amount of exchange differences. (*ITFG 13, Issue 8*)

By indicating that an entity still remains exposed to foreign currency risk, this view appears to support the applicability of hedge accounting in a situation where foreign currency derivatives have been transacted to mitigate foreign currency risk on a long term loan for which an entity continues to apply the policy of capitalising foreign exchange differences on translation in accordance with paragraph D13AA of Ind AS 101. However, ITFG opined that hedge accounting would not be applicable in this scenario (refer section on hedge accounting above). Therefore, further clarity may be required to determine the appropriate accounting treatment for these transactions.





## 4.

# Tangible and intangible assets



Generally non-financial assets recognised by an entity under Ind AS may include, tangible fixed assets such as PPE as well as also intangibles such as technology, brands, etc. This chapter includes a discussion on the following standards on non-financial assets:

- Ind AS 16, *Property, Plant and Equipment*
- Ind AS 38, *Intangible Assets*
- Ind AS 40, *Investment Property*.

## Key principles

- PPE are tangible items that are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes and are expected to be used during more than one period.
- Intangible asset is an identifiable non-monetary asset without physical substance. It is 'identifiable' if it is separable or arises from contractual or legal rights.
- Investment property is property (land or a building-or part of a building-or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both.

## Recognition criteria

- The cost of an item of PPE or an intangible asset is required to be recognised as an asset if, and only if it is probable that future economic benefits associated with the item flow to the entity and the cost of the item can be measured reliably.

- Items such as spare parts, stand-by equipment and servicing equipment are recognised in accordance with Ind AS 16 when they meet the definition of PPE. Otherwise, such items are classified as inventory.

## Measurement at initial recognition

- An item of PPE or an intangible asset that qualifies for recognition as an asset should be measured initially at its cost. The initial measurement of an intangible asset depends on whether it has been acquired separately, acquired as part of a business combination or internally generated.
- Internally generated goodwill, brands, mastheads, publishing titles, customer lists and items similar in substance (e.g. start-up costs, advertising and promotional activities and relocation or a reorganisation expenses) should not be recognised as intangible assets.
- The cost of an item of PPE includes:
  - All expenditure directly attributable to bringing the asset to the location and working condition for its intended use. Also the estimated costs of dismantling and removing the item and restoring the site.
- Internal development expenditure relating to intangible assets is capitalised if specific criteria are met. These capitalisation criteria are applied to all internally developed intangible assets.



- Internal research expenditure is expensed as it is incurred.
- Investment property is initially recognised at cost. After initial recognition all investment property are measured under the cost model.

### Depreciation

- When an item of PPE comprises individual components for which different depreciation methods or rates are appropriate, each component is depreciated separately.
- Any item of PPE or an intangible asset with finite useful life is depreciated/amortised on a systematic basis over its useful life. The depreciable amount of an asset is determined after deducting its residual value.
- The depreciation method/amortisation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.
- An intangible asset with an indefinite useful life is not amortised but tested for impairment.
- The estimates for the residual value, useful life of an asset and the method of depreciation/amortisation should be reviewed at a minimum at each financial

year-end. In addition if expectations differ from previous estimates, the change(s) is accounted for as a change in an accounting estimate in accordance with Ind AS 8.

### Derecognition

- The carrying amount of an item of PPE or an intangible asset should be derecognised on disposal or when no future economic benefits are expected from its use or disposal. The gain or loss arising from the derecognition of an item of PPE is recognised in profit or loss when the item is derecognised unless it is a sale and leaseback. Gains are not to be classified as revenue.
- An investment property shall be derecognised on its disposal or when it is permanently withdrawn from use and no future economic benefits are expected from its disposal. Transfers to or from investment property are made only if there has been a change in the use of the property.
- The intention to sell an investment property without redevelopment does not justify reclassification from investment property into inventory. The property continues to be classified as investment property until disposal unless it is classified as held-for-sale.

## Significant differences from IFRS

### Revenue based amortisation for toll road intangible assets<sup>8</sup>

As per paragraph 7AA in Ind AS 38, the amortisation method prescribed by Ind AS 38 would not apply to an entity that opts to amortise intangible assets arising from service concession arrangements in respect of toll roads in accordance with the exception given in paragraph D22 of Ind AS 101. This exception is applicable to toll road related intangible assets recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS reporting period. This exception should be read in conjunction with Schedule II of the 2013 Act.

8. Source: Appendix 1 (comparison with IAS 38 and SIC 32 to Ind AS 38).

### Applicability of fair value model to investment property<sup>9</sup>

IAS 40, *Investment Property*, permits both cost model and fair value model (except in some situations) for measurement of investment properties after initial recognition while Ind AS 40 permits only the cost model.

IAS 40 permits treatment of property interest held in an operating lease as an investment property, if the definition of investment property is otherwise met and fair value model is applied. In such cases, the operating lease would be accounted as if it were a finance lease. Since Ind AS 40 prohibits the use of fair value model, this treatment is prohibited in Ind AS 40. Also the expression 'investment property under a finance or operating lease' appearing in IAS 40 has been modified as 'investment property under finance lease' in Ind AS 40.

### Accounting for grants related to PPE and intangible asset<sup>9</sup>

In respect of the initial recognition for assets against which government grants have been received, IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance* provides an option to present the grants by either accounting the grant as deferred income or by reducing the grant from carrying amount of PPE. Ind AS 20 requires the presentation of such grants only as deferred income.

Similarly, with regard to the acquisition of an intangible asset by way of a government grant, IAS 38, *Intangible Assets*, provides an option to an entity to recognise both the asset and the grant initially at fair value and at a nominal amount plus any expenditure that is directly attributable to preparing the asset for its intended use. Ind AS 38 allows only fair value for recognising the intangible asset and grant in accordance with Ind AS 20.

In this context, ICAI has recently issued an exposure draft of amendments to Ind AS 20 that proposes to reinstate the option of reducing the grant from the carrying amount of PPE.

## Practical implications out of ITFG clarifications

### Capitalisation of spares

Often entities may purchase spares, standby equipment, etc., which may be used along with the relevant item of PPE. In a situation where an entity uses spare parts for an item of PPE, issues may arise on whether such spare parts should be recognised as inventory or capitalised as PPE and recognised as part of that equipment or whether depreciation should be computed separately for that spare part.

In such a case, spare parts that meet the definition of PPE and satisfy the recognition criteria in Ind AS 16, should be capitalised as PPE separately from the equipment with which it is intended to be used. The depreciation on an item of spare part would begin when the asset is available for use i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by the management.

The spare parts may be readily available for use and may be depreciated from the date of its purchase. In determining the useful life of the spare part, the life of the machine (in respect of which it could be used) could be one of the determining factors. (*ITFG 2, Issue 4*).

(Please refer Chapter 9 on First time Adoption of Ind AS for more details on capitalisation and depreciation of spare parts on transition to Ind AS) (*ITFG 3, Issue 9 and ITFG 5, Issue 6*)

### Capitalisation of enabling assets

Ind AS 16 states that the cost of an asset would include all expenditure directly attributable to bringing the asset to the location and working condition for its intended use. By the same analogy, it is often argued that expenditure on enabling assets (i.e. assets which are not owned or controlled by the entity) should be capitalised as such an expenditure is necessary for facilitating construction of a related item of PPE or making the relevant item of PPE capable of operating in the manner intended by the management.

9. Source: ICAI's publication Indian Accounting Standards (Ind AS): An Overview (Revised September 2017)



Capitalisation of expenditure incurred on construction of enabling assets, such as an access road or a railway siding on a land not owned by an entity, would depend on facts and circumstances of each case. (*ITFG 2, Issue 5*)

The entity may not have ownership rights and consequently these enabling assets would be available for use to other entities and public at large. In such situation, guidance on issues related to manner of capitalisation of enabling assets, their presentation and depreciation is as follows:

- Capitalisation of enabling assets: Ind AS 16 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, although the entity cannot restrict others from using the railway sidings, roads, bridges, etc., these are required to facilitate the construction of the related item of PPE and for its operation. Expenditure on enabling assets is incurred in order to get future economic benefits from the project/PPE as a whole. Hence, these expenses should be capitalised in the financial statements of the entity.

- Presentation of enabling assets: Since the entity may not be able to restrict others from using the enabling asset, it cannot capitalise them as individual items of PPE. Accordingly, the expenditure incurred will be considered as part of the overall cost of the related project and accordingly, would be allocated to and capitalised as a part of the items of the project. These assets would be presented within the class of asset to which they relate.
- Depreciation of enabling assets<sup>10</sup>: 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, enabling assets would be depreciated as follows:
  - *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.

- *Useful life and depreciation method are the same*: If the components have a useful life and depreciation method that are the 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 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 they relate. (*ITFG 11, Issue 8*)

### Accounting for restoration cost in case of a leasehold land

In accordance with guidance provided in Ind AS 16, the cost of an item of PPE comprises the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located. The obligation would be incurred either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

There could be a situation where an entity using a leasehold land (for business purposes) is under an obligation to restore the land to its original condition at the end of the lease period.

In accordance with the principles of Ind AS 17, *Leases*, the entity would be first required to evaluate whether the lease is a finance lease or an operating lease. Thereafter, the accounting treatment of the restoration costs on such a leasehold land, in the books of the lessee would be as below:

- *In case lease is determined to be a finance lease*: All site restoration costs need to be estimated and capitalised at initial recognition of PPE. This should be done in such a manner that the restoration costs can be recovered over the life of PPE, even if the expenditure will only be incurred at the end of the item's life i.e. at the end of the lease period.

Where an obligation exists to restore a site to its former condition at the end of its useful life, the present value of the related future payments is capitalised along with the cost of acquisition or construction upon completion and a corresponding liability is recognised.

10. Also refer to the Education Material on Ind AS 16, *Property, Plant and Equipment* (August 2017) published by Ind AS Implementation Committee of ICAI for detailed guidance.

Further, in accordance with guidance provided in Appendix A to the Ind AS 16, the asset comprising the decommissioning cost is depreciated over its useful life. The periodic unwinding of the discount is recognised as a finance cost in the statement of the profit and loss. Its capitalisation is not permitted under Ind AS 23.

- *In case lease is determined as an operating lease:* In such a case, if the entity incurs an amount to construct the asset/structure on land which it is required to remove on expiration of the lease, then it should account for the removal obligation as it has a present obligation under the lease to remove the improvements at the end of the lease term.

The entity would capitalise leasehold building/improvements and amortise them over the term of the lease.

It is to be noted that the removal obligation arises when the entity completes the construction, which is the past event. Accordingly, the present value of expected outflow should be recognised as a liability when the construction is completed. Further, an asset of the same amount should be recognised and amortised over the remaining lease term. (*ITFG 14, Issue 2*)

### Application of revaluation model for land and building

When an entity that is transitioning to Ind AS has certain immovable properties, such as land or building, it is required to first evaluate whether the land and building held by meets the definition of 'investment property' in accordance with Ind AS 40 or is considered as PPE in accordance with Ind AS 16. The entity may consider if it is permitted to use the revaluation model for such immovable properties instead of cost model in its first Ind AS financial statements on the following basis:

- Land and building is classified as PPE: Measure the land or building initially at cost. For subsequent measurement, the entity has an option to select the cost model or revaluation model for this class of PPE.
- Land and building is classified as an investment property: Only the cost model should be used for initial and subsequent measurement.

A related issue is whether the entity is permitted to opt for the cost model for some classes of PPE and apply the revaluation model for other classes of PPE in its first Ind AS financial statements. As Ind AS 16 states that 'if an item of PPE has been revalued, the entire class of PPE to which that asset belongs should be revalued', therefore the entity may elect to apply the revaluation model to a particular class of PPE and cost model to another class of PPE. (*ITFG 12, Issue 1*)

### Retrospective application of revaluation model in PPE

Ind AS 16 states that in case an asset's carrying amount is increased as a result of a revaluation, the increase should be recognised in OCI and accumulated in equity under the heading of revaluation surplus. Further Ind AS 1, *Presentation of Financial Statements*, states that OCI comprises items of income and expense (including reclassification adjustments) that are not recognised in profit or loss as required or permitted by other Ind AS.

An entity applied revaluation model under previous Indian GAAP. On transition to Ind AS, it elected not to apply the deemed cost exemption under Ind AS 101. The entity opted to retrospectively apply the requirements of Ind AS 16 to all items of PPE and opted for revaluation model of Ind AS 16 for subsequent measurement.

Therefore, the entity should apply the revaluation model of Ind AS 16 to its PPE. On the date of transition to Ind AS, the revaluation reserve determined in accordance with the requirements of Ind AS 16 (carried from previous GAAP) will be recognised as revaluation surplus in equity. The opening balance of revaluation surplus (determined in accordance with previous GAAP) should be transferred to retained earnings or if appropriate, another category of equity. Any revaluation gains arising on subsequent recognition, i.e. after the date of transition, should be recognised in the OCI. (*ITFG 14, Issue 6*)

## Revenue-based amortisation

Ind AS 38 requires the amortisation method used for intangible assets with a finite useful life to reflect the pattern in which the asset's future economic benefits are expected to be consumed by an entity. There is a rebuttable presumption that an amortisation method based on revenue generated based on the use of an intangible asset is inappropriate except in limited circumstances. Generally, intangible assets with a finite useful life are amortised on a straight-line basis over their useful life.

Paragraph 7AA of Ind AS 38 read with paragraph D22 of Ind AS 101 specifically permits revenue-based amortisation for intangible assets arising from service concession arrangements in respect of toll roads recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS reporting period. This method of amortisation is not

generally permitted for intangible assets related to toll roads that are recognised subsequently.

Earlier Schedule II to the 2013 Act, permitted revenue-based amortisation for such intangible asset without any reference to any financial year. This was inconsistent with the guidance in Ind AS 101.

The Schedule II to the 2013 Act was amended by MCA on 9 December 2016 to clarify that Ind AS entities would be unable to apply revenue-based amortisation method to toll road related intangible assets that are recognised after the beginning of the first year of adoption of Ind AS. *(ITFG 3, Issue 13)*

(Please refer Chapter 9 on First time Adoption of Ind AS for more details on revenue-based amortisation of toll roads and application of exemption to toll roads under construction)



## 5.

# Ind AS 12, Income Taxes



## Key principles

- Ind AS 12 includes all domestic and foreign taxes which are based on taxable profits as also withholding taxes (which are payable by a subsidiary, associate or joint venture on distributions to investors).
- Ind AS 12 requires recognition of tax consequences of difference between the carrying amounts of assets and liabilities and their tax base.
- Current tax is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period.
- Deferred tax liabilities are the amounts of income taxes payable in future periods in respect of taxable temporary differences.
- Deferred tax assets are the amounts of income taxes recoverable in future periods in respect of deductible temporary differences, carry forward of unused tax losses and carry forward of unused tax credits.
- A deferred tax asset or liability is not recognised if:
  - It arises from the initial recognition of an asset or liability in a transaction that is not a business combination, and
  - At the time of transaction, it affects neither accounting profit nor taxable profit.

- Deferred tax liability/asset is not recognised in respect of temporary differences associated with investments in subsidiaries, branches, associates and joint arrangements if certain conditions are met. For example, in the case the investor is able to control the timing of the reversal of the temporary differences, and it is probable that the temporary difference will not reverse in the foreseeable future.
- A deferred tax asset shall be recognised for the carry forward of unused tax losses and unused tax credits to the extent that it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised.

## Measurement

- Current and deferred taxes are measured based on rates that are enacted or substantively enacted at the reporting date.
- Deferred tax liabilities and assets are measured based on the expected manner of settlement (liability) or recovery (asset).
- Deferred tax assets and liabilities are not discounted.
- The carrying amount of a deferred tax asset shall be reviewed at the end of each reporting period.
- The total income tax expense (income) recognised in a period is the sum of current tax plus the change in deferred tax assets and liabilities during the period, excluding tax recognised outside profit or loss.

- Tax consequences that relate to changes in the recognised amount of equity, in the same or a different period (not included in profit or loss), shall be charged or credited directly to equity.
- Tax consequences that relate to amounts recognised in Other Comprehensive Income (OCI) shall be recognised in OCI.

#### Presentation

- Deferred tax asset or liability is classified as a non-current asset or liability respectively in the balance sheet.

#### Offsetting

- The current tax assets and current tax liabilities can only be offset against each other when the entity has a legally enforceable right to set off and it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.
- The same principle as above applies for offsetting deferred tax assets and deferred tax liabilities.

#### Significant differences from IFRS<sup>11</sup>

IAS 12, *Income Taxes*, provides that acquired deferred tax benefits recognised within the measurement period that results from new information about facts and circumstances existed at the acquisition date shall be applied to reduce the carrying amount of goodwill related to that acquisition. If the carrying amount of that goodwill is zero, any remaining deferred tax benefits shall be recognised in profit and loss. However, under Ind AS 103 as bargain purchase gain is recognised in capital reserve rather than in profit or loss, therefore under Ind AS 12, if the carrying amount of such goodwill is zero, any remaining deferred tax benefits would be recognised in OCI and accumulated in equity as capital reserve or recognised directly in capital reserve.

### Practical implications arising out of ITFG clarifications

#### Recognition of deferred tax on freehold land

Ind AS 12 requires a deferred tax asset/liability is to be created for all deductible/taxable temporary differences, except in specified situations e.g., if it arises from a transaction that affects neither accounting profit nor taxable profit (tax loss) at the time of the transaction (known as initial recognition exemption).

In addition, Ind AS 12 requires the measurement of deferred tax assets or liabilities to reflect the tax consequences that would follow from the manner in which the entity expects, at the end of the reporting period, to recover or settle the carrying amount of its assets/liabilities. This may require the exercise of judgement based on facts and circumstances.

Ind AS 12 also specifies that if a non-depreciable asset is measured using the revaluation model under Ind AS 16, the related deferred tax asset or deferred tax liability is measured based on the tax consequences of recovering the carrying amount of such asset through sale, regardless of the basis of measuring its carrying amount.

At times, entities hold free hold land which is sometimes expected to be sold on a slump-sale basis and not individually. In such cases, an issue may arise whether or not to recognise a deferred tax asset on such land since it will be sold on a slump sale basis and hence a temporary tax difference would not exist.

Accounting of deferred taxes on freehold land could be a highly judgemental area for entities under Ind AS as it involves considerable estimation. Therefore, entities, should consider all facts and circumstances while accounting for deferred taxes and disclose the judgement taken in respect to deferred taxes on freehold land. To address such uncertainty, steps provided on next page could be helpful:

11. Source: ICAI's publication Indian Accounting Standards (Ind AS): An Overview (Revised September 2017)

- Consider all factors concerning its expected profitability, both favourable and unfavourable, when assessing whether a deferred tax asset should be recognised on the basis of availability of future taxable profits. A deferred tax asset should be recognised if:
  - An entity has stable earnings history
  - There is no evidence to suggest that current earnings level will not continue into the future, and
  - There is no evidence to suggest that the tax benefits will not be realised for some other reason.
- Assess if the fair value of freehold land is higher than its tax base (due to indexation), then this is a factor taken into account in assessing the probability of whether taxable profits will be available to offset the deductible temporary difference in future.
- While assessing an entity should also take into account the appropriate scheduling of the reversal of such temporary differences. If the assessment is favourable, then a deferred tax asset should be recognised for the deductible temporary differences.
- Assess the situation where an entity does not have an intention to sell freehold land separately, for example, it has constructed a factory on that land and the factory is vital for its operations. The entity should also assess its past experience of slump-sale of such assets.

The difficulty of estimating the timing of the reversal of the temporary difference is not in itself a reason for not recognising a deferred tax asset. However, it is a relevant factor in assessing the probability of the availability of future tax profits.

In such a case where an entity held freehold land expected to be sold on slump sale basis, ITFG clarified that the entity would be required to exercise judgement to determine whether the freehold land will be sold through a slump sale. If so, then the tax base of the land would be the same as its carrying amount as an indexation benefit is not available in case of slump sale under the Income-tax Act, 1961 (IT Act). Therefore, there would be no temporary difference and consequently no deferred tax asset would be recognised. (*ITFG 7 Issue 7*)

### Deferred taxes on capitalised exchange differences

AS 11, *The Effects of Changes in Foreign Exchange Rates*, provided a relief to the entities from reporting adverse impact of volatility in exchange rate difference by providing the following options:

- a. Adjusted to the cost of the asset, where the long-term foreign currency monetary items relate to the acquisition of a depreciable capital asset (whether purchased within or outside India), and consequently depreciated over such asset's balance life, or
- b. Accumulated in 'Foreign Currency Monetary Item Translation Difference Account' (FCMITDA) and amortised over the balance period of long-term monetary asset/liability but not beyond 31 March 2020, in cases other than those falling under (a) above.

On transition to Ind AS, Ind AS 101 and Ind AS 21, *The Effects of Changes in Foreign Exchange Rates*, allow entities to recognise foreign exchange adjustments as per the policy adopted under previous GAAP. Therefore, exchange differences arising from translation of long-term foreign currency monetary items recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period can continue to be accounted for as per the previous GAAP.

Accordingly certain entities that availed the relief provided by AS 11 would have added to or deducted exchange gain/loss on foreign currency loan from the cost of Property, Plant and Equipment (PPE), before adoption of Ind AS. However, such exchange differences capitalised are not allowed deduction under the IT Act, 1961 including Income Computation and Disclosure Standards (ICDS). In addition, entities that chose to follow the previous GAAP accounting policy post transition, such adjustment would lead to temporary differences and recognition of deferred taxes through statement of profit and loss. Such adjustments are likely to bring volatility to the statement of profit and loss.

Entities would need to recognise deferred taxes on such differences arising from the adjustment of exchange difference to the cost of the asset. (*ITFG 8, Issue 8*)



### Deferred tax on undistributed profits

The practical implications on accounting of deferred tax on undistributed profits are discussed in detail under various situations as follows:

- i. When a parent receives dividend from its wholly-owned subsidiary during the year and the subsidiary would pay Dividend Distribution Tax (DDT) thereon as per tax laws to the taxation authorities.

At the time of consolidation, the dividend income earned by the parent would be eliminated against the dividend recorded in its equity by the subsidiary as a result of consolidation adjustment. The DDT paid by the subsidiary to the taxation authorities (being outside the consolidation group) would be charged as expense in the consolidated statement of profit and loss of the parent (presuming that parent is unable to claim an offset against its own DDT liability).

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 it has been clarified that the parent may be required to recognise deferred tax liability in the consolidated financial statement (measured based on the DDT expense of the subsidiary) to the extent of proposed dividend of the subsidiary, recognition of deferred tax asset to the extent of offset may not be recognised pending receipt of approval from the shareholders of the parent. (*ITFG 9, Issue 1*)

- ii. Another situation involving a parent which receives dividend from a subsidiary which is not wholly owned say, the parent owns 60 per cent stake in the subsidiary and the subsidiary pays a dividend at the rate of INR10 per share and DDT at the rate of 20 per cent

In such a situation, dividend income earned by the parent and the dividend recorded by the subsidiary in its equity would be eliminated in the CFS of the holding entity as a result of consolidation adjustment while dividend paid to the NCI shareholders would be recorded in the statement of changes in equity as a reduction in the NCI balance (as the shares are classified as equity in accordance with Ind AS 32).

It is important to note here, that the DDT paid to the taxation authorities by the subsidiary has two components - that paid in relation to the parent entity and the other paid in relation to NCI. As already explained earlier, the DDT relating to the parent entity would be charged as tax expense in the consolidated statement of profit and loss of the parent since this is paid outside the group. With regard to the DDT paid on dividend related to NCI, it would be recognised in the statement of changes in equity along with the portion of such dividend paid to the NCI.

In the same situation, further assume that the parent also pays dividend to its shareholders and assuming that it is eligible to claim an off-set in respect of its DDT liability to the taxation authorities to the tune of DDT paid by its subsidiary on its behalf. Then in such a situation, the total amount of DDT (i.e. DDT paid by the subsidiary as well as the additional DDT paid by the parent after utilising the offset claimed in respect of DDT paid by the subsidiary) should be recognised in the consolidated statement of changes in equity of the parent entity since the share of the parent in the DDT paid by the subsidiary was utilised by the parent for payment of dividend to its own shareholders.

In addition, it has been clarified that due to parent's transaction of distribution of dividend to its shareholders (a transaction recorded in parent's equity) and the related DDT set-off, the DDT paid by the subsidiary is effectively a tax on distribution of dividend to the shareholders of the parent entity. Therefore the DDT paid by the subsidiary and additional DDT paid by parent (on account of distribution of dividend to its shareholders and claiming the off-set thereon) should be recognised in the consolidated statement of changes in equity of the parent entity and no amount would be charged to the consolidated statement of profit and loss.

Also, it is important to note that in case the DDT liability of the parent is lower as compared to the off-set available on account of DDT paid by the subsidiary, then in such a case, the amount of DDT liability paid by the subsidiary which could not be utilised as an offset by the parent should be charged to consolidated statement of profit and loss.

- iii. In a situation where DDT has been paid by an associate to its investor, since such DDT paid by an associate is not allowed to be set-off against the DDT liability of the investor, then the investor's share of DDT would be accounted by the investor entity by crediting its investment account in the associate and recording a corresponding debit adjustment towards its share of profit or loss of the associate. (*ITFG 13, Issue 9*)

Thus, entities 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 statements 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.

### **Applicability of Accounting Standard Interpretations (ASIs) issued under previous GAAP to situations of tax holiday under Ind AS**

An entity may be entitled to tax holiday under Sections 80-IA and 80-IB of the IT Act.

Under the previous GAAP, certain ASIs were issued by ICAI to provide guidance on applicability of AS 22, *Accounting for Taxes on Income*, in the situations of tax holiday under section 80-IA and 80-IB of the IT Act. Some of these, subsequently were included in the relevant standard i.e. AS 22, by means of explanations and thus became part of previous GAAP.

AS 22 clarified that deferred taxes in respect of timing differences which reverse during the tax holiday period should not be recognised to the extent the entity'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.

ASIs 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 are required to be applied. Accordingly, under Ind AS, deferred taxes in respect of temporary differences which 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 in accordance with the requirements of section 80IA/80IB of the IT Act. (*ITFG 11, Issue 2*)

### **Recognition of deferred tax on tax deductible goodwill of subsidiary, not recognised in CFS**

Issue considered involved a situation where two subsidiaries of an entity were amalgamated and as a result of this transaction, a goodwill was recognised in the separate financial statement (SFS) of the amalgamated entity under previous GAAP. This goodwill is allowed as deduction under income tax laws in the books of the amalgamated entity. On transition to Ind AS, the parent entity availed of the optional exemption under Ind AS 101 and decided not to restate its past business combinations. Accordingly, on the date of transition to Ind AS such accounting goodwill got eliminated as a result of consolidation adjustment in the CFS. However, there was an increase in the tax base of assets in the CFS of parent entity resulting from such tax deductible goodwill.

In this situation an issue arises whether deferred tax asset on the tax deductible goodwill should be recognised in the CFS of parent entity prepared as per Ind AS when there is no corresponding accounting goodwill in the CFS.

A deferred tax may be recognised for assets or liabilities with a tax base but nil carrying amount in the financial statements since Ind AS 12 states that some items have a tax base but are not recognised as assets and liabilities in the balance sheet.

In this situation, it is assumed that the tax base of the goodwill will be the amount that will be allowed as deduction in future in accordance with the IT Act.

Accordingly, deferred tax asset on the tax base of goodwill should be recognised in accordance with Ind AS 12 by crediting the consolidated statement of profit and loss, to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised, in the CFS of the parent.

In this situation, it was assumed that the tax base of the goodwill will be the amount that will be allowed as deduction in future in accordance with the IT Act.

Additionally, this will not qualify for the initial recognition exemption under Ind AS 12 as there is no initial recognition of an asset or liability arising from the amalgamation of subsidiaries in the CFS of parent entity (the impact of amalgamation of subsidiaries is eliminated in the CFS of the parent entity). (*ITFG 10, Issue 3*)



## 6. Ind AS 18, Revenue



### Key principles

- Ind AS 18 is applied in accounting for revenue arising from the sale of goods, the rendering of services and the use by others of entity's assets yielding interest and royalties. Though it deals with recognition of interest, measurement of interest and recognition and measurement of dividend are dealt in accordance with Ind AS 109, *Financial Instruments*.
- Under Ind AS 18, revenue is recognised when it is probable that future economic benefits will flow to the entity and these benefits can be measured reliably.
- Revenue is the gross inflow of economic benefits received by an entity on its own account during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants.
- Where an agency relationship exists, amounts collected on behalf of the principal are not recognised as revenue by the agent.
- The recognition criteria are usually applied separately to each transaction. However, in certain circumstances, it is necessary to apply the recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction.
- Conversely, the recognition criteria are applied to two or more transactions together when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole.
- Revenue is measured at the fair value of consideration received, taking into account any trade discount and volume rebates.
- If a transaction includes a financing element, then revenue is measured by discounting all future cash receipts at an imputed interest rate.
- For, *Customer Loyalty Programmes*, in which a third party supplies the awards, the entity shall assess whether it is collecting the consideration allocated to the award credits on its own account (i.e. as the principal in the transaction) or on behalf of the third party (i.e. as an agent for the third party).
- *The Guidance Note on Accounting for Real Estate Transactions (for entities to whom Ind AS is applicable)* issued in May 2016 recommends the accounting treatment by entities dealing in real estate as sellers or developers.

### Significant carve-outs from IFRS<sup>12</sup>

- On the basis of IAS 18, *Revenue*, IFRIC 15, *Agreement for Construction of Real Estate* prescribes that construction of real estate should be treated as sale of goods and revenue should be recognised when the entity has transferred significant risks and rewards of ownership and retained neither continuing managerial involvement nor effective control.
- IFRIC 15 has not been included in Ind AS 18 to scope out such agreements from Ind AS 18. A separate guidance note on accounting for real estate developers (for Ind AS compliant entities) has been issued by the ICAI to address the matter.

### Practical implications arising out of ITFG clarifications

#### Disclosure of excise duty as an expense\*

Ind AS 18 does not specifically prescribe any guidance for presentation of excise duty. But in accordance with Division - II of Schedule III to the 2013 Act, (i.e., Ind AS based Schedule III) – Note 3 of General Instructions for Preparation of Statement of Profit and Loss, provides that revenue from operations shall disclose separately in the notes:

- a. Sale of products (including excise duty);
- b. Sale of services and
- c. Other operating revenues.

Therefore, based on the above guidance, it has been clarified that in the statement of profit and loss prepared under Ind AS, revenue is the gross amount including excise duty, and excise duty should be reflected as an expense in the statement of profit and loss under Ind AS. (*ITFG 4, Issue 1*)

### Service tax would not form part of revenue

Typically, entities collect service tax from customers for rendering of services. Service tax is generally collected on behalf of a third party, viz., the government. Amounts collected on behalf of third parties such as sales taxes, goods and services taxes and value added taxes are not economic benefits which flow to the entity and do not result in increases in equity. Accordingly revenue should be net of service tax collected in the statement of profit and loss. (*ITFG 4, Issue 2*)

### Accounting treatment of customer loyalty programmes

An entity may participate in a customer loyalty programme operated by a third party. The members of the programme can earn points for purchases made in the entity's stores and can redeem the points for goods supplied by the third party. The obligation of the entity to the members is fulfilled once the members have been granted points when making purchases in its stores. The obligation to supply the redeemed goods lay with the third party. Assuming that at the end of 31 March 20XX, the entity granted award points with an estimated fair value of INR20,000 and owed the third party INR17,000.

With regard to the accounting treatment and classification of expenses incurred for providing free third party goods to its customer, in the given case the entity will assess based on facts and circumstances as to whether it is acting as an agent or principal.

If it is determined that X is acting as an agent, then it will recognise only commission income of INR3,000. However, if it is concluded that X is acting as a principal, then revenue recognised by X will be INR20,000 and INR 17,000, being cost of goods sold, will be charged to the statement of profit and loss. (*ITFG 10, Issue 6*)

12. Source: ICAI's publication Indian Accounting Standards (Ind AS): An Overview (Revised September 2017)

\*This issue would apply to few companies e.g. petroleum products and tobacco.



This clarification on the classification of expenses for providing free third party goods would also apply to similar arrangements where customers are entitled to receive free third party products or services based on the volume of purchases made from the reporting entity. Say, a customer becomes entitled to earn reward miles when it avails the services of an airlines and subsequently these accumulated reward miles can be redeemed either for free or discounted airline tickets of the same airlines or at a stay in a holiday resort of a third party, etc. on the basis of arrangements entered into by the airlines. These reward miles are accounted as a separately identifiable component of the initial sales transaction and the fair value of the consideration received or receivable in respect of the initial sale would be allocated between the reward miles and other components of the sale.

#### **Adjustments of advance payments received for goods or services for the effect of time value of money**

An entity may have entered into a contract to supply goods and services to be provided over a long period of time and required advance payments from its customers. This is a contract to supply goods and services and did not contain an embedded lease as covered within the scope of Appendix C, *Determining Whether an Arrangement contains a Lease* to Ind AS 17, *Leases*. It is also not covered within the scope of Appendix C, *Transfers of Assets from Customers* to Ind AS 18 and does not meet the definition of a derivative under Ind AS 109.

An issue can arise whether the entity would need to make an adjustment to advance payments received for the effect of time value of money.

The principle laid down in Ind AS 18 provides that entities are required to measure revenue 'at the fair value of the consideration received or receivable'.

In addition, Ind AS 18, provides in most cases, the consideration is in the form of cash or cash equivalents

and the amount of revenue is the amount of cash or cash equivalents received or receivable. However, when the inflow of cash or cash equivalents is deferred, the fair value of the consideration may be less than the nominal amount of cash received or receivable. For example, an entity may provide interest-free credit to the buyer or accept a note receivable bearing a below-market interest rate from the buyer as consideration for the sale of goods. When the arrangement effectively constitutes a financing transaction, the fair value of the consideration is determined by discounting all future receipts using an imputed rate of interest.

Therefore, in such a case where entity received advance payments from the customer for providing relevant goods or services over a long period of time, then by analogy to above examples, it should evaluate whether the payment terms provide it with a significant benefit of financing.

At the time of making such an evaluation, judgement is required to be exercised. Additionally, the following factors may also need to be considered:

- Whether the arrangement has been entered in the normal course of business
- Whether payment of advance is as per typical payment terms within industry and do not have a primary purpose of financing
- Whether advance receipt is a security for a future supply of limited goods or services or such other relevant factors depending on facts and circumstances of each case.

If it is concluded that the arrangement effectively constitutes a significant financing component, or in other words, a loan provided by the customer to the supplier for providing the relevant goods or services, then the entity should adjust the consideration (including advance payments) for the effect of time value of money. (*ITFG 14, Issue 3*)



# 7. Ind AS 17, Leases



## Key principles

- Ind AS 17 requires leases to be classified based on the extent to which risks and rewards incidental to ownership of a leased asset lie with the lessor or the lessee.
- A lease is classified at inception, based on the substance of the transaction, as a finance lease if it transfers substantially all the risks and rewards incidental to ownership, else it is classified as an operating lease.
- A lease of land with a building is treated as two separate leases - a lease of land and a lease of building as the two may be classified differently.
- The fact that land normally has an indefinite life, is an important consideration in determining its classification as a finance lease or an operating lease.

## Leases in the financial statements of lessees

### Operating Lease

- Lease payments are recognised as an expense on a straight-line basis over the lease term unless either another systematic basis is more representative of the time pattern of the user's benefit or the payments are structured to increase in line with expected general inflation.

### Finance leases

- Assets and liabilities are required to be recognised in balance sheets at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments, each determined at the inception of the lease. The discount rate to be used in calculating the present value of the minimum lease payments is generally the interest rate implicit in the lease. Any initial direct costs of the lessee are added to the amount recognised as an asset.
- Minimum lease payments shall be apportioned between the finance charge and the reduction of the outstanding liability. Contingent rents shall be charged as expenses in the periods in which they are incurred.
- A finance lease gives rise to depreciation expense for depreciable assets as well as finance expense for each accounting period. The depreciation policy for depreciable leased assets shall be consistent with that for depreciable assets that are owned, and the depreciation recognised shall be calculated in accordance with Ind AS 16 and Ind AS 38.

## Leases in the financial statements of lessors

### Operating leases

- Assets are presented in the balance sheet according to their nature and depreciation policy for such leased assets is required to be consistent with the lessor's normal depreciation policy for similar assets.
- Lease income (excluding amounts for services such as insurance and maintenance) is required to be recognised in income on a straight-line basis over the lease term unless either:
  - Another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished, even if the payments to the lessors are not on that basis or
  - The payments to the lessor are structured to increase in line with expected general inflation to compensate for the lessor's expected inflationary cost increases. If payments to the lessor vary according to factors other than inflation, then this condition is not met.

### Finance leases

- Lessors are required to recognise assets in their balance sheets and present them as a receivable at an amount equal to the net investment in the lease.

- A lessor should generally recognise the aggregate cost of incentives in an operating lease as a reduction of rental income over the lease term, on a straight-line basis. The lessee should generally recognise the aggregate benefit of incentives as a reduction of rental expense over the lease term, on a straight-line basis.

### Determining whether an arrangement contains a lease

Appendix C of Ind AS 17 provides guidance on the following aspects:

- For determining whether the arrangement is, or contains, leases that should be accounted for in accordance with Ind AS 17
- When the assessment or a reassessment of whether an arrangement is, or contains, a lease should be made and
- If an arrangement is, or contains, a lease, how the payments for the lease should be separated from payments for any other elements in the arrangement.

## Significant differences from IFRS<sup>13</sup>

### Escalation of lease rentals for expected inflation

IAS 17, *Leases*, requires all leases rentals to be charged to statement of profit and loss on a straight-line basis in case of operating leases unless another systematic basis is more representative of the time pattern of the user's benefit even if the payments to the lessor are not on that basis. However, Ind AS 17 provides that lease rentals, in case of operating leases, shall be charged to the statement of profit and loss on a straight-line basis in accordance with the lease agreement unless the payments to the lessor are structured to increase in line with expected general inflation to compensate for the lessor's expected inflationary cost increases. If payments to the lessor vary because of factors other than general inflation, then this condition is not met.

Considering the Indian inflationary situation, lease agreements contain periodic rent escalation. Accordingly, where there is periodic rent escalation in line with the expected inflation so as to compensate the lessor for expected inflationary cost increases, the rentals should not be straight-lined.

13. Source: ICAI's publication Indian Accounting Standards (Ind AS): An Overview (Revised September 2017)

### Presentation of property interest under operating leases

IAS 17 provides that separate measurement of land and building elements is not required when the lessee's interest in both land and buildings is classified as an investment property in accordance with Ind AS 40, *Investment Property* and fair value model is adopted. IAS 17 also permits property interest held under an operating lease to be presented as investment property, if the definition of investment property is otherwise met and fair value model is applied. Since Ind AS 40 prohibits the use of fair value model, these provisions of IAS 17 are not included in Ind AS 17.

## Practical implications arising out of ITFG clarifications

### Classification of long-term lease of land

Often business situations involve lease of land for use of the entity in its business. In the previous GAAP, AS 19, *Leases*, excluded lease of land from the scope of the standard, however, Ind AS 17 includes lease of land in its scope and requires an entity to separately classify a lease of land, from a lease of buildings.

In addition, classification of a lease of land as a finance or operating lease in the books of a lessee, may involve judgement based on evaluation of specific facts and circumstances while considering the guidance given in the standard. For example, a situation where an entity obtains land from the government on a long-term lease basis (which spans 99 years or more) and at the end of the lease term, the lease could be extended for another term or the land could be returned to the government authority. In such a case, in accordance with the guidance in Ind AS 17, the following factors may be relevant in classifying a long-term lease of land:

- A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership of an asset.
- One of the indicators of a finance lease is that 'at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset.'
- Another important indicator is that 'the lease term is for the major part of the economic life of the asset even if title is not transferred.' Land normally has an indefinite economic life and it is expected that the value of land generally appreciates. Therefore, this could indicate that the lease is an operating lease.
- Additional indicators to consider in an overall context of whether substantially all risks and rewards have been transferred, include the company's ability to renew the lease for another term at substantially below market rent, option to purchase the land at a price significantly below fair value, etc. (*ITFG 7, Issue 5*)

Thus, classification of a lease into an operating or a financing lease requires considerable judgement based on a careful evaluation of facts and circumstances.

*Accounting for restoration cost in case of a leasehold land*

For further discussion on the topic, please refer Chapter 4 on Tangible and Intangible Assets (*ITFG 14, Issue 2*)

### Lease rent with escalation clause

Ind AS 17 requires operating lease payments to be expensed on a straight-line basis over the period of lease unless the payments to the lessor are structured to increase in line with expected general inflation to compensate for the lessor's expected inflationary cost increases. However, if payments to the lessor vary because of factors other than general inflation, then lease payments shall be straight-lined.

For example, a five-year operating lease arrangement that permits escalation of lease rent at the rate of 15 per cent per annum, while the general inflation in the country expected for the aforesaid period is around six per cent would require careful evaluation to ascertain the real intent for escalation in lease payments.

Further, in situations where a lease agreement specifies a fixed escalation rate for lease rentals, and if the actual increase or decrease in the rate of inflation is not materially different as compared to the expected rate of inflation/escalation rate under the lease agreement, the lease payments are not required to be straight lined. However, in such a case the purpose of such escalation should be only to compensate for the expected general inflation rate.

Accordingly, in cases where the fixed escalation rate for lease rentals does not appear to have any link with general inflation, the entire lease payments should be straight-lined. This indicates that an entity would also not be able to strip out a component of the escalation that is inflation-linked and would have to recognise the entire lease rental including the escalation on a straight-line basis. (*ITFG 5, Issue 7*)





# Ind AS 21, The Effects of Changes in Foreign Exchange Rates



## Key principles

Ind AS 21 should be applied in:

- Accounting for transactions and balances in foreign currencies, except for those derivative transactions and balances that are within the scope of Ind AS 109, *Financial Instruments*
- Translating the results and balance sheet of foreign operations that are included in the financial statements of the entity by consolidation or the equity method and
- Translating an entity's results and balance sheet into a presentation currency.

## Functional currency

- The entity measures its assets, liabilities, income and expenses in its functional currency, which is the currency of the primary economic environment in which it operates. An entity's functional currency reflects the underlying transactions, events and conditions that are relevant to it. Accordingly, once determined, the functional currency is not changed unless there is a change in those underlying transactions, events and conditions.
- Transactions that are not denominated in an entity's functional currency are foreign currency transactions.

## Recognition

### Initial recognition

- A foreign currency transaction should be recorded in the functional currency, by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of the transaction.

### Subsequent measurement

- At the end of each reporting period:
  - Foreign currency monetary items should be translated using the closing rate
  - Non-monetary items that are measured in terms of historical cost in a foreign currency should be translated using the exchange rate at the date of the transaction and
  - Non-monetary items that are measured at fair value in a foreign currency should be translated using the exchange rates at the date when the fair value was measured.

## Presentation currency

- The entity may present its financial statements in a currency other than its functional currency (presentation currency). The entity that translates its financial statements into a presentation currency other than its functional currency uses the same method as for translating the financial statements of a foreign operation.

## Disposal or partial disposal of a foreign operation

- If the entity disposes of its entire interest in a foreign operation or loses control over a foreign subsidiary, or retains neither joint control nor significant influence over an associate or joint arrangement as a result of partial disposal, then the cumulative amount of the exchange differences relating to that foreign operation, recognised in OCI and accumulated in the separate component of equity, should be reclassified from equity to the statement of profit and loss (as a reclassification adjustment) when the gain or loss on disposal is recognised.
- A partial disposal of a foreign subsidiary without the loss of control leads to proportionate reclassification of the cumulative exchange differences from OCI to Non-Controlling Interest (NCI).

## Supplementary financial information

- An entity may present supplementary financial information in a currency other than its presentation currency if certain disclosures are made.

## Significant differences from IFRS<sup>14</sup>

- Ind AS 101, read with Ind AS 21, provides companies with an option to continue the policy adopted as per previous GAAP/AS in accounting for exchange differences arising from translation of long-term foreign currency monetary items recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period.
- When there is a change in functional currency of either the reporting entity or a significant foreign operation, IAS 21, *The Effects of Changes in Foreign Exchange Rates*, requires disclosure of that fact and the reason for the change in functional currency. Ind AS 21 requires an additional disclosure of the date of change in functional currency.

## Practical implications arising out of ITFG clarifications

### Determination of functional currency

Often situations arise where a company may have two or more distinct business with different functional currencies. The accounting principles in Ind AS 21 provide that functional currency is the currency of the primary economic environment in which the entity operates. Therefore, functional currency needs to be identified at the entity level, considering the economic environment in which the entity operates, and not at the level of a business or a division.

14. Source: ICAI publication Indian Accounting Standards (Ind AS): An Overview (Revised September 2017)

Ind AS 21 provides additional guidance with respect to factors which an entity should consider while determining its functional currency. These factors include the following:

- Currency that influences sales prices for goods and services and is of a country whose competitive forces and regulations determine the sales prices of its goods and services
- Currency that influences labour, material and other costs of providing goods or services
- Currency in which funds from financing activities are generated and
- Currency in which receipts from operating activities are usually retained. (*ITFG 3, Issue 3*)

#### **Determination of presentation currency for CFS**

Entities within a group may have different functional currencies. Ind AS 21 requires each entity to determine its functional currency and translate foreign currency

items into functional currency and report effects of such translation in the financial statements. Ind AS 21 also permits an entity to use a presentation currency for reporting its financial statements that differs from its functional currency.

Ind AS 21 provides specific guidance on translating the results and balance sheet of an entity into a different presentation currency.

Accordingly, if an entity is statutorily required to present its financial statements in a currency which is different from its functional currency, then it may do so by choosing the other currency as its presentation currency and applying the translation procedures as given in Ind AS 21.

Additionally, the auditor of such an entity (whose financial statements are prepared in a presentation currency which is different from its functional currency) would be required to give an auditor's report on financial statements prepared in the presentation currency. (*ITFG 7, Issue 2*)









# Ind AS 101, First Time Adoption of Indian Accounting Standards



## Key principles

- Ind AS 101 provides a suitable starting point for entities that are transitioning to Ind AS. Ind AS 101 is applied by an entity in its first Ind AS financial statements and each interim financial report, if any, that it presents in accordance with Ind AS 34, *Interim Financial Reporting*.
- The date of transition is the beginning of the earliest comparative period presented on the basis of Ind AS. At least one year of comparatives is also presented together with the opening balance sheet, which is prepared at the date of transition to Ind AS.

## Accounting policies

- An entity is required 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.
- Accounting policies are required to be chosen from Ind AS effective at the end of its first Ind AS reporting period, unless there is an explicit exemption or option provided in Ind AS 101.
- An entity is required in its opening Ind AS balance sheet to:
  - Recognise all assets and liabilities whose recognition is required by Ind AS

- Not recognise items as assets or liabilities if Ind AS do not permit such recognition
- Reclassify items that it recognised in accordance with previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity in accordance with Ind AS, and
- Apply Ind AS in measuring all recognised assets and liabilities.
- The accounting policies in the opening Ind AS balance sheet may differ from those that an entity used for the same date under previous GAAP. The resulting adjustments arising from events and transactions before the date of transition to Ind AS are generally recognised in retained earnings.
- Ind AS 101 establishes the following two categories of exceptions to the principle that an entity's opening Ind AS balance sheet should comply with each Ind AS:
  - Prohibits retrospective application of some specific aspects of an Ind AS.
  - Grants exemptions from some specific requirements of an Ind AS.

## Explanation of transition to Ind AS

- An entity is required to explain how the transition from previous GAAP to Ind AS affected its reported balance sheet, financial performance and cash flows.

## Disclosures

- Detailed disclosures on the first-time adoption of Ind AS including reconciliations of equity and profit or loss from previous GAAP to Ind AS are required in the annual financial statements as well as some disclosures in its interim financial statements.

### Significant differences from IFRS<sup>15</sup>

- **Definition of previous GAAP**

IFRS 1, *First time Adoption of International Financial Reporting Standards* defines previous GAAP as the basis of accounting that a first time adopter used immediately before adopting IFRS.

Ind AS 101 defines previous GAAP as the basis of accounting that a first-time adopter used for its reporting requirement in India immediately before adopting Ind AS. The change made it mandatory for Indian entities to consider the financial statements prepared in accordance with the notified Accounting Standards as was applicable to them as previous GAAP when it transitions to Ind AS.

- **Deemed cost for PPE/intangible assets/investment property/investments in subsidiaries, associates and joint ventures**

IFRS 1 provides that on the date of transition the carrying amount for items of property, plant and equipment (PPE), intangible assets, investment property, or investments in subsidiaries, associates and joint ventures (as presented in the separate financial statements), should be measured by either applying the relevant Ind AS retrospectively or at their fair value.

Paragraph D7AA of Ind AS 101 provides an additional option to measure these items on the date of transition at their carrying amount in accordance with previous GAAP and use this amount as a measure of their deemed cost.

- **Foreign currency translation on long term monetary items**

Paragraph D13AA of Appendix D to Ind AS 101 provides that a first-time adopter may continue the previous GAAP policy adopted for accounting for exchange differences arising from translation of long-term foreign currency monetary items recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period. Consequently, Ind AS 21 also provides that it does not apply to long-term foreign currency monetary items for which an entity has availed of the exemption in paragraph D13AA of Appendix D to Ind AS 101.

IFRS 1 does not include a similar exemption for long term foreign currency monetary items.

- **Adjustment in goodwill**

IFRS 1 requires a first-time adopter to exclude from its opening balance sheet, any item recognised in accordance with previous GAAP that does not qualify for recognition as an asset or liability under IFRS. The first-time adopter shall account for the resulting change in retained earnings as at the transition date except in certain specific instances where it requires adjustment in goodwill. In such specific instances where IFRS 1 allows an adjustment in goodwill, under Ind AS 101 this amount may be adjusted in capital reserve to the extent it does not exceed the balance available in capital reserve.

15. Source: ICAI's publication Indian Accounting Standards (Ind AS): An Overview (Revised September 2017)

- **Lease of land and buildings**

Paragraph D9AA of Ind AS 101 provides that when a lease includes both land and building elements, a first time adopter may assess the classification of each element as finance or an operating lease at the date of transition to Ind AS on the basis of the facts and circumstances existing as at that date. If there is any land lease newly classified as finance lease then a first time adopter may recognise assets and liability at fair value on that date; any difference between those fair values is recognised in retained earnings.

- **Investment property**

Paragraph D7(a) of IFRS 1 provides that option to take fair value at the date of transition to Ind AS or previous GAAP revalued amount may be exercised by a first item adopter for investment property. However, this option has not been provided under Ind AS 101, as Ind AS 40, *Investment Property* permits only the cost model.

- **Service concession arrangements relating to toll roads**

Paragraph D22 of Ind AS 101 permits a first-time adopter to continue the amortisation policy adopted under previous GAAP for intangible assets arising from 'toll-road' service concession arrangements that were recognised in the financial statements before the beginning of the first Ind AS financial reporting period. Therefore, entities that have adopted a revenue based amortisation policy for such intangible assets under previous GAAP are permitted to continue applying such policy for toll road intangible assets recognised prior to the Ind AS implementation date.

## Key differences arising out of the requirements of the 2013 Act

- An entity may be required to comply with the accounting, presentation and disclosure requirements prescribe in a court approved scheme relating to a merger or amalgamation transaction. The requirements of Ind AS 101 may stand modified to this extent.
- Section 2(43) of the 2013 Act defines 'free reserve' to mean such reserves which, as per the latest audited balance sheet of a company are available for distribution of dividend, except:
  - Any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or
  - Any change in carrying amount of an asset or of a liability recognised in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value.

With Ind AS becoming applicable to certain classes of companies and in the absence of any clarification from MCA, there continues to be some uncertainty on whether certain adjustments to retained earnings (on first-time adoption of Ind AS) would be considered while computing free reserves.

## Practical implications arising out of ITFG clarifications

### I. Clarifications with respect to the application of the deemed cost exemption

As stated above, Ind AS 101 permits an entity to measure items of PPE, investment property, intangible assets and investments in subsidiaries/ associates/joint ventures on the date of transition at either their fair value or their carrying amount in accordance with previous GAAP and use this amount as a measure of their deemed cost.

The application of this optional exemption gives rise to several accounting issues, especially when considering the interaction of this exemption in Ind AS 101 with the requirements of other Ind AS. These issues are further discussed below.

#### a. Applicability of deemed cost exemption

Paragraph D7AA of Ind AS 101, provides an option to a first time adopter at the date of transition to continue with the carrying value of *all* PPE (or intangible assets or investment property) measured as per previous GAAP, and use it as its deemed cost without making any further adjustments based on application of other Ind AS.

Alternatively, Ind AS 101 also permits a first-time adopter to elect to measure an item of PPE at the date of transition to Ind AS at its fair value and use that fair value as its deemed cost on transition. This option may be applied selectively to some items of PPE.

However, an entity is not permitted to continue with the previous GAAP carrying value as deemed cost on a selective basis for some of the items of PPE and use fair value as deemed cost approach for the remaining items. (*ITFG 5, Issue 3*)

The ICAI on 27 April 2017 issued an Exposure Draft (ED) for a limited amendment to Ind AS 101 with regard to the deemed cost approach. The ED proposes to allow companies to apply the 'previous GAAP carrying value as deemed cost' for a class of PPE instead of all its PPE and allows an entity to make adjustments to the deemed cost which may arise due to application of other Ind AS. However,

this ED is yet to be notified by MCA/ICAI. Entities that are transitioning to Ind AS may apply this proposed amendment, when notified.

### b. Reversal of the effects of paragraph 46/46A of AS 11 under previous GAAP carrying amount of PPE on transition to Ind AS

As mentioned above, paragraph D7AA of Ind AS 101 permits an entity transitioning to Ind AS, to use the carrying amount for all of its PPE as recognised in its financial statements under previous GAAP on the date of transition to Ind AS, as its deemed cost under Ind AS. An entity that avails of this deemed cost exemption would be required to carry forward the entire previous GAAP carrying amount for all of its PPE on transition to Ind AS. Ind AS 101 does not permit any further adjustments to the deemed cost of PPE.

Under previous GAAP, an entity may have availed of the option under paragraph 46/46A of AS 11 to capitalise foreign exchange differences on long-term foreign currency items to the cost of the related PPE. At the time of transition to Ind AS if such an entity decides to avail of the deemed cost exemption under paragraph D7AA of Ind AS 101, but does not elect to continue to capitalise foreign exchange differences (also refer section II below), it would still be required to carry forward the entire previous GAAP carrying amount for all of its PPE and would not be permitted to reverse the impact of paragraph 46/46A of AS 11 from the deemed cost of PPE. (*ITFG 7, Issue 3*)

Subsequent to issuing the above clarification in bulletin 7, the ITFG clarified (refer paragraph I (c) below) that the deemed cost of an asset, being its previous GAAP carrying amount, may be adjusted only to the extent of consequential adjustments arising from the application of other Ind AS (*ITFG 12, Issue 10*). The ICAI's ED of amendments to Ind AS 101 issued in April 2017, (although not yet notified) also proposed amendments that would enable consequential changes arising from the application of other Ind AS to be adjusted from the deemed cost of an asset. Entities may consider re-evaluating this application issue if any change is made to Ind AS 101 in future.

**c. Consequential adjustments to deemed cost, being the previous GAAP carrying amount of assets and liabilities**

An entity is required to recognise, classify and measure assets and liabilities in its opening Ind AS balance sheet in accordance with Ind AS.

Based on the above guidance, and subject to any specific exemption/exception in Ind AS 101, all assets and liabilities are required to be recognised in accordance with the principles of Ind AS 101.

However, there may be situations where no exemption/exception has been provided for an item of asset and/or liability, and the application of Ind AS principles to such an item has a corresponding impact on another item of asset and/or liability which is measured at its previous GAAP carrying amount at the transition date as permitted by Ind AS 101.

In such a situation, the adjustment to the assets/liabilities measured at deemed cost is only consequential in nature and arises due to the application of the transition requirements of Ind AS 101 to another item. Therefore, the previous GAAP carrying amount may be adjusted only to the extent of consequential adjustments. Except such consequential adjustments, no further adjustments should be made to the deemed cost (being the previous GAAP carrying amount) due to the application of other Ind AS. (*ITFG 12, Issue 10*). This clarification is more general in nature, although clarifications have been provided in the past on specific consequential adjustments – please refer paragraph I (d) and (e) below.

This clarification may result in additional adjustments being made to the deemed cost of PPE for items such as certain borrowing costs, hedging gains/losses, etc.

**d. Processing fees on loans**

An entity may have incurred processing fees on a loan obtained before transition to Ind AS and capitalised these as part of the relevant item of PPE in accordance with the previous GAAP. On transition to Ind AS, an entity may elect to apply

the deemed cost exemption and continue with the previous GAAP carrying value for such PPE.

However, the loan is required to be measured at amortised cost in accordance with Ind AS 109 and its carrying amount is to be restated to its amortised cost in accordance with Ind AS 109 as at the date of transition. As a consequence, in order to restate the carrying amount of loan, the deemed cost of the PPE, being its previous GAAP carrying amount at the date of transition, should also be reduced by the amount of processing cost (net of cumulative depreciation impact). This would be in the nature of consequential adjustment to enable an adjustment to the carrying amount of loan as required by Ind AS. (*ITFG 5, Issue 4*)

**e. Government grants for purchase of a fixed asset**

An entity may have received a government grant related to an asset, prior to the date of transition to Ind AS. As permitted under previous GAAP, the amount of grant received may have been deducted from the carrying amount of the related asset. The certain issues may arise based on whether the entity elects to measure the related asset at its previous GAAP carrying amount or at fair value as its deemed cost on transition. Those issues are as follows:

*i. Carrying value as deemed cost:* On transition to Ind AS, the entity may avail of the deemed cost exemption to continue with the carrying amount of PPE in accordance with the previous GAAP.

The government grant outstanding on the transition date is required to be recognised as deferred income in accordance with the requirements of Ind AS 20. Therefore, to recognise the amount of unamortised deferred income as at the date of the transition in accordance with Ind AS 101, a consequential adjustment should be made to the carrying amount of PPE (net of cumulative depreciation impact) and retained earnings respectively, even though the PPE is measured at its deemed cost (being previous GAAP carrying amount). (*ITFG 5, Issue 5*)



ii. *Fair value as deemed cost:* The entity may elect to measure its PPE at fair value and use that as its deemed cost on the date of transition to Ind AS in accordance with principles of Ind AS 101. Considering the principles in Ind AS 113, *Fair Value Measurement*, fair value of the asset is the exit price that would be received to sell the asset in an orderly transaction. As fair value is a market-based measurement and not an entity specific measurement, it is independent of the government grant received on the asset. Consequently, no adjustment with regard to government grant should be made to the fair value of the PPE, being the deemed cost on the date of transition to Ind AS. However, the entity is required to recognise the asset related government grant outstanding on the transition date as deferred income in accordance with the requirements of Ind AS 20. The resultant adjustments should therefore be made in retained earnings or if appropriate, another category of equity at the date of transition to Ind AS. (ITFG 12, Issue 2)

The ICAI has recently issued an Exposure Draft (ED) of amendments to Ind AS 20 which now provides an option to deduct asset-related grants from the carrying amount of the related item of PPE. This is aligned with the accounting policy choices available in IAS 20 internationally. Therefore, entities transitioning to Ind AS, that elect to apply the deemed cost exemption and measure their PPE at the previous GAAP carrying amount should consider if an adjustment to the carrying amount of PPE to recognise the grant as deferred income would still be permitted on transition, since this may no longer be considered a consequential adjustment arising from the mandatory application of another Ind AS.

#### **f. Capital spares**

An entity that has elected to continue with the carrying value under previous GAAP as the deemed cost for all of its PPE on transition to Ind AS, may have capital spares that were recognised as inventory under previous GAAP but are eligible for capitalisation under Ind AS. On transition to Ind AS such capital spares should be recognised as a part of PPE if they meet the criteria for capitalisation under Ind AS 16. Ind AS 16 should be applied retrospectively to measure the amount that will

be recognised for such spare parts on the date of transition to Ind AS. Depreciation on these spare parts should begin from the date when they are available for use. The exemption to continue with the carrying value of PPE under previous GAAP as the deemed cost would not apply to such capital spares since these were not recognised as PPE under previous GAAP. (ITFG 3, Issue 9 and ITFG 5, Issue 6)

#### **g. Capital work in progress**

Capital work in progress is considered to be in the nature of PPE under construction. Accordingly, the optional exemption under paragraph D7AA of Ind AS 101, to continue with the carrying value under previous GAAP as deemed cost under Ind AS, is also available with regards to capital work in progress. (ITFG 3, Issue 11)

#### **h. Capitalisation of an item of PPE not falling under the definition of an asset**

The deemed cost exemption under paragraph D7AA of Ind AS 101 cannot be availed for an asset that did not meet the definition of a tangible asset under previous GAAP (or PPE under Ind AS) and was incorrectly capitalised under previous GAAP. Instead, the incorrect capitalisation would be considered as an error under Ind AS 101 and disclosed in the net worth reconciliation. (ITFG 8, Issue 4)

#### **i. Revalued amount of PPE considered as deemed cost**

An entity that has revalued its PPE in the past may, at the date of transition to Ind AS, elect to continue with the revised carrying value of its PPE under previous GAAP and use that as its deemed cost under Ind AS 101. If such an entity elects to apply the cost model (i.e. to carry PPE at cost less accumulated depreciation and impairment losses) for subsequent measurement of its PPE under Ind AS 16, it should not carry forward the revaluation reserve (created under previous GAAP) under Ind AS. This is because, after transition, the entity would no longer be applying the revaluation model under Ind AS 16. Additionally, deferred tax would need to be recognised on such asset to the extent of the difference between its carrying value in the financial statements and the tax base. (ITFG 8, Issue 7)

**j. Reversal of impairment provision**

If an entity elects to apply the deemed cost exemption under Ind AS 101 and measure its PPE at its previous GAAP revaluation amount on transition, the revalued amounts of PPE as per previous GAAP, are considered as cost under Ind AS. In this case, accumulated depreciation and provision for impairment under previous GAAP have no relevance, and cannot be carried forward or reversed under Ind AS. However, the impairment loss for the period between the deemed cost determination date (date of revaluation under previous GAAP) and the transition date (when Ind AS accounting and depreciation policies are applied to the asset to arrive at its cost on date of transition under Ind AS) may be reversed if permitted under Ind AS 36, *Impairment of Assets*.

However, where an entity has not availed of the deemed cost exemption and has opted to apply Ind AS 16 retrospectively in accordance with paragraph 7 of Ind AS 101, then impairment loss can be reversed if permitted by Ind AS 36. (*ITFG 8, Issue 5*)

**k. Applicability of deemed cost exemption on assets classified as held for sale**

Under previous GAAP 'assets held for sale' in accordance with AS 10, *Property, Plant and Equipment*, may be stated at lower of their net book value and net realisable value and presented separately from other fixed assets. On transition to Ind AS, if these assets are found not to fulfil the criteria for being classified as 'held for sale' in accordance with Ind AS 105, *Non-current assets held for Sale and Discontinued Operations*, then such assets should be reclassified as PPE.

However, the entity can avail the deemed cost exemption for such assets since the exemption applies to all PPE recognised in the financial statements at the date of transition to Ind AS, including those that were presented/disclosed separately. (*ITFG 10, Issue 4*)

**l. Deemed cost of an investment in a subsidiary**

On transition date, a first-time adopter can determine cost of its investment in a subsidiary, associate or joint venture recognised in SFS by using any of the following methods:

- Cost determined in accordance with Ind AS 27 (i.e. retrospective application of Ind AS 27)
- Fair value at the entity's date of transition to Ind AS
- Previous GAAP carrying amount.

Accordingly, if an entity chooses to measure its investment at fair value at the date of transition then fair value is deemed to be cost of such investment for the entity and, therefore, it should carry its investment at that amount (i.e. fair value at the date of transition) after the date of transition. (*ITFG 3, Issue 12*)

**m. Investment in debentures of a subsidiary company**

Ind AS 27 requires an entity to account for its investments in subsidiaries, joint ventures and associates either at cost, or in accordance with Ind AS 109 (i.e. at fair value) in its SFS. Further, if an entity elects a cost based measurement for such investments, Ind AS 101 permits the investment to be measured at its deemed cost, being its fair value or its previous GAAP carrying amount on the date of transition to Ind AS.

However, the guidance in Ind AS 27 and Ind AS 101 stated above, is applicable only to those investments in a subsidiary, associate or joint venture that meet the definition of an 'equity' instrument (from the issuer's perspective) under Ind AS 32. Therefore, for example, if an entity invests in debentures issued by its subsidiary, which are classified as a financial liability by the subsidiary, it would have to classify the investment as a financial asset and measure this in accordance with Ind AS 109. The deemed cost exemption in Ind AS 101 would not apply to such an investment.

(Please refer Chapter 10 on Other topics - SFS for more details on investments in debentures of a subsidiary) (*ITFG 7, Issue 8*)

**n. Accounting for interest-free loan provided by holding entity in its SFS**

On transition to Ind AS, an entity that has advanced an interest-free loan to its subsidiary, is required to recognise the difference between the present value of the loan amount and its carrying amount as per previous GAAP as an addition to its investment in the subsidiary in its SFS. If the entity elects to measure its investment in the subsidiary at its previous GAAP carrying amount, being deemed cost, in its SFS, in accordance with Ind AS 101, then the difference between the carrying amount of the loan as per previous GAAP and its present value, would be considered a consequential adjustment (due to application of Ind AS 109 to the loan) and should be added to the deemed cost of its investment in the subsidiary. (*ITFG 10, Issue 1*)

This is consistent, in principle, with the clarifications on consequential adjustments to deemed cost of tangible and intangible assets. (Please refer paragraphs I (c), (d) and (e) above).

**o. Measurement of investment in subsidiaries, joint ventures and associates at the end of the first Ind AS financial reporting period**

When an entity prepares SFS, Ind AS 27 requires it to account for its investments in subsidiaries, joint ventures and associates either at cost or in accordance with Ind AS 109.

If an entity has elected to measure a particular category of investment (e.g. its investments in its subsidiaries) at deemed cost on the date of transition, it is required to carry such investment at cost in its first Ind AS financial statements prepared as at the end of the reporting period. However, for investments made in other categories where it has not selected the deemed cost exemption (e.g. investments in associates or joint ventures), the company would have an option to account for those investments either at cost or in accordance with Ind AS 109. (*ITFG 11, Issue 4*)

Once an entity chooses the method of accounting (i.e. deemed cost and cost based measurement or measurement in accordance with Ind AS 109) for a particular category of investment, it is required to continue with the same accounting policy for that category of investment.

**II. Clarifications with respect to application of the exemption to continue with the accounting policy under para 46A of AS 11**

Under previous GAAP an entity was permitted by paragraph 46/46A of AS 11 to capitalise foreign exchange gains or losses on long-term foreign currency monetary items. If selected, this option permitted such exchange gains/losses to be either capitalised into the cost of a related item of PPE, or accumulated in a reserve named Foreign Currency Monetary Item Translation Difference Account (FCMITDA).

(Please refer Chapter 5 on Income Taxes for deferred taxes on capitalised exchange differences. (*ITFG, Issue 8*). Also refer Chapter 10 on Other topics - Earnings Per Share for consideration of amounts debited to FCMITDA for computation of basic EPS (*ITFG 10, Issue 5*)).

Paragraph D13AA of Ind AS 101, permits a first-time adopter to continue the accounting policy adopted under previous GAAP for exchange differences

arising from translation of long-term foreign currency monetary items recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period.

The application of this exemption in Ind AS 101 gives rise to several practical implementation issues, which are highlighted below.

**a. Applicability of exemption under paragraph D13AA of Ind AS 101**

The option (under Ind AS 101) to continue with the accounting policy under paragraph 46/46A of AS 11, *The Effects of Changes in Foreign Exchange Rates* is available for only those long term foreign currency loans that were taken/drawn down before the beginning of the first Ind AS reporting period i.e. 1 April 2017 for a company falling within phase 2 of the Ind AS adoption road map. (*ITFG 1, Issue 3*) and (*ITFG 7, Issue 1*)

**b. Amortisation of FCMITDA on transition to Ind AS**

Ind AS 109 provides guidance on the measurement of financial liabilities classified into the amortised cost category and requires the application of the Effective Interest Rate (EIR) method to measure amortised cost. The application of this method may result in a change in the carrying amount of a long term foreign currency liability on transition to Ind AS, as compared to previous GAAP. If an entity applies the exemption in paragraph D13AA of Ind AS 101 and continues to accumulate foreign exchange gains or losses on translation of such an item in FCMITDA, the balance in FCMITDA should be revised retrospectively on the basis of the amortised cost of the liability (as determined under Ind AS 109 on the date of transition). The revised balance of FCMITDA should be amortised over the balance period of that long-term liability through the statement of profit and loss. (*ITFG 2, Issue 1 and 6*)

**c. Exemption under paragraph D13AA on change in functional currency**

When the functional currency of a company changes from INR to any other currency (e.g. USD), then any loans taken in the new functional currency (USD) would not be considered as long-term foreign currency monetary items under previous GAAP (paragraph 46A of AS 11). Therefore, an entity cannot continue to recognise the exchange differences arising from those loans, in the cost of fixed assets under paragraph D13AA of Ind AS 101. (*ITFG 1, Issue 4*)

#### **d. Accounting policy for exchange differences to long-term forward exchange contracts**

Companies that availed of the option to apply paragraph 46/46A of AS 11 under previous GAAP may have also capitalised foreign exchange differences on forward exchange contracts (covered by paragraph 36 of AS 11) acquired to hedge long-term foreign currency loans. This was permitted in accordance with the clarification issued by ICAI in its Frequently Asked Questions (FAQs) on the AS 11 notification.

However, the exemption in paragraph D13AA of Ind AS 101 relates only to foreign exchange differences on long-term foreign currency monetary items recognised in the financial statements prior to the first Ind AS financial reporting period and would not apply to long-term forward exchange contracts. *(ITFG 7, Issue 4)*

Long-term forward exchange contracts would meet the definition of a derivative and are within the scope of Ind AS 109. These derivatives would have to be recognised at fair value through profit or loss unless hedge accounting principles apply and these are designated in a qualifying cash flow hedge relationship under Ind AS 109. (Please also refer paragraph II (e) below)

#### **e. Application of hedge accounting principles where an entity avails option under para 46A of AS 11**

On transition to Ind AS, an entity may continue to capitalise foreign exchange differences arising on translation of long term foreign currency loans into the cost of a related asset, in accordance with the exemption in Ind AS 101. The entity may have also entered into derivative transactions (e.g., forward contracts or cross currency swaps) to hedge the cash flows on the long term foreign currency loan.

However, the entity would not be permitted to apply hedge accounting under Ind AS to such derivatives. This is because the entity is considered to have no corresponding foreign exchange exposure that affects profit or loss, since it capitalises the exchange differences. *(ITFG 3, Issue 10)*

Also refer Chapter 3 on Financial Instruments. *(ITFG 3, Issue 10 and ITFG 13, Issue 8)*

#### **Clarifications with respect to application of the exemption for service concession arrangements**

Paragraph D22 of Ind AS 101 specifically permits an entity to continue with its amortisation policy adopted under previous GAAP for intangible assets arising from service concession arrangements in respect of toll roads. This, read with paragraph 7AA of Ind AS 38, therefore permits an entity to continue with revenue based amortisation for such intangible assets (related to toll roads) recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS reporting period. This method of amortisation is not permitted for intangible assets related to toll roads that are recognised subsequently.

#### **a. Revenue-based amortisation for toll roads**

The ITFG clarified that in harmonisation of the Companies (Accounts) Rules, 2014, Ind AS 38 and Ind AS 101, the principles of Ind AS 38 should be followed for all intangible assets related to service concession arrangements including toll roads once Ind AS is applicable to an entity. Accordingly, revenue-based amortisation would generally not apply to such intangible assets, except in accordance with paragraph D22 of Ind AS 101, which provides a specific exemption for toll road intangibles recognised in the financial statements before the beginning of the first Ind AS reporting period. *(ITFG 3, Issue 13)*

#### **b. Application of exemption to toll roads under construction**

Another practical issue is with reference to applicability of this exemption to toll roads under construction/development. The exemption applies only to intangible assets arising from toll-road concession arrangements recognised in the financial statements before the beginning of first Ind AS reporting period. An entity cannot avail of the exemption if the construction of the toll road is in progress on such date, since the related intangible asset would not have been recognised prior to the beginning of the first Ind AS reporting period. *(ITFG 7, Issue 9)*



## Other clarifications

The following are other significant application issues arising from the implementation of the guidance in Ind AS 101:

### a. Retrospective application of Ind AS 109 to financial instruments acquired in past business combinations

Ind AS 101 provides entities transitioning to Ind AS with an option to not apply Ind AS 103, *Business Combinations* retrospectively to business combinations that occurred before the date of transition to Ind AS.

Where an entity acquires another entity in a scheme of amalgamation approved under the provisions of the 2013 Act, prior to its date of transition to Ind AS and avails of the option to not restate its past business combinations, it considers the previous GAAP carrying amounts of assets acquired and liabilities assumed to be their deemed cost on the date of transition to Ind AS.

On the other hand, while preparing its opening Ind AS balance sheet, Ind AS 101 requires an entity to apply the criteria in Ind AS 109 to classify financial instruments on the basis of the facts and circumstances that exist at the date of transition to Ind AS. The resulting classifications are applied retrospectively.

While Ind AS 101 does not specifically provide any transitional relief for financial instruments, it also does not specify the accounting treatment if an entity elects not to restate its past business combinations, giving rise to an application issue.

In this scenario, the previous GAAP carrying amounts of financial instruments acquired as part of the business combination would be their deemed cost at the date of the business combination. The fair value or amortised cost (as required by Ind AS 109) of such financial instruments should be determined from the date of business combination and not from the date of origination by the acquiree company. Accordingly, the financial instruments would be measured in the following manner:

- *Financial instruments classified as Fair Value Through Profit or Loss (FVTPL)/Fair Value Through Other Comprehensive Income (FVOCI)*: Measured at their fair value on the date of transition to Ind AS.

- *Financial instruments classified at amortised cost*: The carrying amount of the instrument should be computed on the date of transition to Ind AS, based on the previous GAAP carrying amount at the date of business combination (under previous GAAP) and the effective interest rate as on that date (determined after considering the amount and timing of expected settlement of such financial instrument). (*ITFG 12, Issue 9*)

### b. Date of transition for presentation of opening balance sheet

As per Ind AS 101, an entity is required to prepare and present an opening Ind AS balance sheet at the date of transition to Ind AS and this is the starting point for its accounting.

It is clarified that on the date of transition to Ind AS, an entity would prepare its balance sheet as on the start of that day. For example, the balance sheet of an entity with transition date as 1 April 2016 would be prepared as on date of transition to Ind AS i.e. the beginning of business on 1 April 2016 (or, equivalently, close of business on 31 March 2016). (*ITFG 8, Issue 3*)

### c. Determination of date for assessing functional currency

Ind AS 101 provides for certain exceptions and exemptions from retrospective application of other Ind AS. However, there is no specific guidance regarding the date of assessment for determination of functional currency by an entity, i.e., whether this would be assessed as on the date of transition to Ind AS or retrospectively. In accordance with principles in Ind AS 101, since neither any exception nor any exemption has been provided, an entity would be required to assess its functional currency retrospectively. (*ITFG 1, Issue 5*)

### d. Premium on redemption of financial liabilities

Companies may have adjusted redemption premiums and/or other transaction costs incurred on financial liabilities (as defined in Ind AS 109) issued before transition to Ind AS against the securities premium account under previous GAAP. However, this is not permitted in Ind AS 109, which requires such redemption premium and transaction costs to be adjusted in the EIR of the financial liability.



Accordingly, ICAI clarified that the difference between the carrying amount of the financial liability (as per previous GAAP) on the date of transition and its amortised cost as on that date, computed as per the EIR method specified in Ind AS 109, should be adjusted by crediting the capital reserve account and the corresponding debit would be to the relevant account which was credited earlier. *(ICAI FAQ dated 7 April 2017)*

Companies that have previously adjusted the entire redemption premium against the securities premium account and recognised the full repayable amount of the liability would be required to reverse the unamortised premium expense on transition to Ind AS. This would subsequently be recognised as an interest expense through the statement of profit and loss over the remaining period until redemption. This could have a significant impact on the determination of future profits under Ind AS.

#### **e. Depreciation on first time adoption**

An entity, being a first-time adopter of Ind AS is required by Ind AS 101 to measure its PPE on the date of transition either by retrospectively applying Ind AS 16 or at deemed cost (being either fair value or previous GAAP carrying amount at the date of transition).

If the entity elects to measure its PPE by retrospective application of Ind AS 16, it is not permitted to re-estimate its depreciation, unless its estimate of depreciation in the previous GAAP was in error. However, when an entity has not estimated the useful life of its assets, but has depreciated its assets as per the minimum requirements of law (at the rates prescribed under Schedule XIV to the Companies Act, 1956), then it would be required to re-compute the depreciation by assessing the useful life of the asset in accordance with Ind AS 16. *(ITFG 3, Issue 14)*

#### **f. Accounting treatment of government loans at a below-market rate of interest**

Ind AS 101 requires a first-time adopter to apply the requirements in Ind AS 109 and Ind AS 20 prospectively to government loans existing at the date of transition to Ind AS. Therefore, the carrying amount

of government loan, under previous GAAP, would continue to be recognised at the date of transition to Ind AS. Although Ind AS 20 requires that the benefit of a government loan at a below-market rate of interest is treated as a government grant, such benefit (based on a retrospective restatement of the loan amount at its fair value on initial recognition under Ind AS 109) would not be recognised for a government loan existing at the date of transition, since Ind AS 101 does not permit such retrospective restatement.

A first-time adopter is required to use its previous GAAP carrying amount of government loan as the Ind AS carrying amount on the date of transition. It should apply the requirements of Ind AS 20 and Ind AS 109, prospectively to government loans existing at the date of transition to Ind AS, unless the necessary information needed to apply the requirements of Ind AS 109 and Ind AS 20 retrospectively, has been obtained at the time of initially accounting for that loan. On prospective application of Ind AS 109, the EIR of the loan should be computed by comparing the carrying amount of the loan at the date of transition with the amount and timing of expected repayment to the government.

Another important related issue is whether such exemption would apply to the deferment of a liability payable to government based on agreement, i.e. liability similar to sales tax deferment for 10 years. Often in such deferral schemes (e.g., where the amount of sales tax collected by an entity from its customers is retained by the entity and is required to be repaid after a specified number of years) are similar in nature to an interest-free loan. Hence, Ind AS 109 and Ind AS 20 should also be prospectively applied to such balances (e.g., deferred sales tax liabilities) outstanding at the date of transition. *(ITFG 12, Issue 7)*. Entities are, therefore, not required to remeasure their deferred sales tax liabilities outstanding at the date of transition.



# 10. Other topics



## Ind AS 1, *Presentation of Financial Statements*

### Key principles

- Ind AS 1 prescribes the basis for presentation of general purpose financial statements<sup>16</sup> to ensure comparability both with the entity's financial statements of previous periods and with the financial statements of other entities. It sets out overall requirements for the presentation of both CFS and SFS, guidelines for their structure and minimum requirements for their content.
- A complete set of financial statements comprises the following:
  - A balance sheet
  - A statement of profit and loss
  - A statement of changes in equity
  - A statement of cash flows
  - Notes, including accounting policies
  - Comparative information, and
  - A balance sheet as at the beginning of the preceding period in certain circumstances.
- Entities are required to prepare financial statements on a going concern basis unless management intends to either liquidate the entity or to cease trading, or has no realistic alternative but to do so.
- The standard requires specific disclosures in the balance sheet, the statement of profit and loss, or the statement of changes in equity (minimum disclosures) and requires additional disclosures (wherever required) to be made either in those statements or in the notes.
 

A statement of changes in equity (and related notes) reconciles opening to closing amounts for each component of equity.

16. For entities operating in sectors such as banking, insurance, electricity, etc., specific formats for presentation of financial statements may be prescribed, accordingly Ind AS 1 may not be applicable to that extent.

- All owner-related changes in equity are presented in the statement of changes in equity separately from non-owner changes in equity (which are presented in single statement of profit and loss).
- Generally, the entity presents its balance sheet classified between current and non-current assets and liabilities.
- An asset is classified as current if it is expected to be realised in the normal operating cycle or within 12 months, it is held for trading or is cash or a cash equivalent.
- A liability is classified as current if it is expected to be settled in the normal operating cycle, it is due within 12 months, or there are no unconditional rights to defer its settlement for at least 12 months.
- A liability that is payable on demand because certain conditions are breached is not classified as current if the lender has agreed, after the reporting date but before the financial statements are authorised for issue, not to demand repayment.

### Schedule III

- The Schedule III to the 2013 Act provides general instructions for preparation of financial statements of a company whose financial statements are required to comply with Ind AS. Schedule III is divided into two parts, i.e. Division I and II, with Division II being applicable to a company whose financial statements are drawn up in compliance with Ind AS.

### ICAI Guidance Note on Division II-Ind AS Schedule III to the 2013 Act (GN)

- The ICAI on 27 July 2017 issued a GN to provide guidance in the preparation and presentation of financial statements in accordance with Ind AS Schedule III, for entities adopting Ind AS. The disclosure requirements under Ind AS, the 2013 Act, other pronouncements of the ICAI, other statutes, etc., would be in addition to the guidance provided in this GN.

### Significant differences from IFRS<sup>17</sup>

- IAS 1, *Presentation of Financial Statements*, requires that in case of a loan liability, if any condition of the loan agreement which was classified as non-current is breached on the reporting date, such loan liability should be classified as current, even if the breach is rectified after the balance sheet date. However, Ind AS 1 clarifies that where there is a breach of a material provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand on the reporting date, the entity does not classify the liability as current, if the lender agreed, after the reporting period and before the approval of the financial statements for issue, not to demand payment as a consequence of the breach.

Carve out has been made considering that if the breach is rectified after the balance sheet date and before the approval of the financial statements, it would be appropriate that the users are informed about the true nature of liabilities being non-current liabilities and not current liabilities.

- Ind AS 1 allows only the single statement approach with profit or loss and other comprehensive income presented in two sections.
- IAS 1 requires an entity to present an analysis of expenses recognised in profit or loss using a classification based on either their nature or their function within the entity, whichever provides information that is reliable and more relevant. Ind AS 1 requires only nature-wise classification of expenses.

17. Source: ICAI's publication Indian Accounting Standards (Ind AS): An Overview (Revised September 2017)

## Practical implications arising out of ITFG clarifications

### Presentation of operating profit as a separate line item not permitted

Ind AS based Schedule III requires disclosure of aggregate of 'revenue from operations' and 'other income' on face of the statement of profit and loss. Revenue from operations is to be separately disclosed in the notes, showing revenue from:

- Sale of products (including excise duty)
- Sale of services and
- Other operating revenues.

The aggregate of 'other income' is to be disclosed on face of the statement of profit and loss. In accordance with the Note 5 of general instructions for the preparation of statement of profit and loss 'other income' is required to be classified as:

- Interest income
- Dividend Income and
- Other non-operating income (net of expenses directly attributable to such income).

The Ind AS based Schedule III does not define the term 'other operating revenue'. Additionally, Ind AS based Schedule III does not specifically require disclosure of an 'operating profit'.

The ICAI issued a GN (as mentioned above) and according to the GN, 'other operating revenue' would include revenue arising from a company's operating activities, i.e., either its principal or ancillary revenue-generating activities, but which is not revenue arising from sale of products or rendering of services. Accordingly, an entity should decide classification of an income based on the facts of each case and detailed understanding of the company's activities.

In addition, Schedule III (Ind AS) to the 2013 Act sets out the minimum requirements for disclosure in the financial statements including notes. It states that line items, sub-line items and sub-totals shall be presented as an addition or substitution on the face of the financial statements when such presentation is relevant to the understanding of the company's financial position or performance or to cater to industry/sector-specific disclosure requirements, apart from, when required for compliance with amendments to the 2013 Act or Ind AS.

The GN illustrates certain financial measures e.g. Earnings before Interest, Tax, Depreciation and Amortisation (EBITDA) as an additional line item on the face of the statement of profit and loss.

However, applying the same analogy in respect of operating profit disclosure may not be appropriate since certain items which are credited to the statement of profit and loss may not form part of operating profit measure. As a result giving a separate line item for disclosure of the operating profit may not be appropriate and would result in change in the format of statement of profit and loss as prescribed by Schedule III applicable to Ind AS companies.

Moreover, Ind AS Schedule III and Ind AS 1 require classification of expense by nature and not by function. The operating profit measure sub-total may result in a more appropriate presentation of performance for entities classifying expenses by function, but classification of expenses by function is not permitted. Therefore, a company would not be able to present an operating profit measure sub-total as part of the statement of profit and loss. However, the entity may provide such additional information in the financial statements. (*ITFG 13, Issue 5*)

### Classification of security deposits accepted by utility companies as current liabilities

In one of the earlier ITFG clarifications, which was subsequently withdrawn, items such as security deposits accepted by utility entities were required to be classified as 'current liabilities' since the entities do not have the unconditional right to defer their repayment for a period of 12 months after the reporting date. This is regardless of whether an entity expects to settle such deposits within this time frame.

This view was consistent with the view provided in the Education Material on Ind AS 1 issued by the Ind AS committee of ICAI. However, previously, under the Revised Schedule VI to the Companies Act, 1956, companies were permitted in specific cases based on commercial practice (such as in the case of utility companies) to classify security deposits collected as non-current. Therefore, entities that have followed a different practice prior to Ind AS implementation would need to evaluate presentation of such deposits.



# Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors

## Key principles

- Ind AS 8 prescribes the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors.
- Accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.
- Ind AS 8 prescribes a two-step approach in selection and application of the accounting policies - when an Ind AS specifically covers a particular issue then accounting policy is determined by applying the Ind AS and in the absence of an Ind AS, the entity applies judgement based on the hierarchy of accounting literature.
- An entity is required to select and apply the accounting policies consistently for similar transactions, other events and conditions, unless an Ind AS specifically requires or permits categorisation of items for which different policies may be appropriate. If an Ind AS requires or permits such categorisation, an appropriate accounting policy should be selected and applied consistently to each category.
- An entity is permitted to change an accounting policy only if the change is required by an Ind AS or results in the financial statements providing reliable and more relevant information.
- In case an entity has not applied a new Ind AS that has been issued but is not yet effective, it is required to disclose this fact along with known or reasonably estimable information relevant to assessing the possible impact that application of the new Ind AS will have on the entity's financial statements in the period of initial application.
- A change in 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 method would be accounted for as a change in an accounting estimate of the entity.
- The effect of change in an accounting estimate is required to be recognised prospectively by including it in profit or loss in the period of the change, if it affects that period only or the period of the change and future periods, where it affects both.
- Prior period errors are omissions from, and misstatements in, the entity's financial statements for one or more prior periods.
- Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.
- Except to the extent that it is impracticable to determine either the period specific effects or the cumulative effect of the error, Ind AS 8 requires to correct material prior period errors retrospectively in the first set of financial statements approved for issue after their discovery by:
  - Restating the comparative amounts for the prior period(s) presented in which the error occurred or
  - If the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.
- Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements.
- Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.
- If the classification and presentation of items in the financial statements is changed, then the entity should restate the comparative unless this is impracticable.
- Disclosure is required for judgements that have a significant impact on the financial statements and for key sources of estimation uncertainty.

### Significant differences with IFRS<sup>18</sup>

IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors* provides that IFRS are accompanied by guidance to assist entities in applying their requirements. Guidance that is an integral part of IFRS is mandatory. Guidance that is not an integral part of IFRS does not contain requirements for financial statements. Ind AS 8, relevant paragraph has been modified by not including the text given in the context of the guidance forming non-integral part of the Ind AS as such guidance has not been given in the Ind AS.

### Practical implications arising out of ITFG clarifications

#### Disclosure of impact of new standard not yet effective

In a situation where an entity has not applied a new Ind AS that has been issued but is not yet effective, Ind AS 8 requires the disclosure of the fact that the issued Ind AS (not yet effective) has not been applied. Additionally, disclosure is required of known or reasonably estimable information relevant to assess the possible impact that application of the new Ind AS is likely to have on an entity's financial statements in the period of initial application.

New Ind AS standards (e.g. Ind AS 115, *Revenue from Contracts with Customers*), are expected to be applicable from 1 April 2018. Ind AS 115, was earlier notified under Companies (Indian Accounting Standards) Rules, 2015, vide notification dated 16 February 2015, but was later withdrawn under Companies (Indian Accounting Standards) (Amendments) Rules, 2016 vide notification dated 30 March 2016, and has been omitted from the Rules.

As Ind AS 115, *Revenue from Contracts with Customers* has not yet been notified by MCA, companies in India do not need to disclose the impact of Ind AS 115 for the financial year ending 31 March 2017. (*ITFG 8, Issue 2*)

Internationally, IFRS 15, *Revenue from Contracts with Customers* is applicable from 1 January 2018 and IFRS 16, *Leases*, would be applicable from 1 April 2019. These standards would eventually be applicable to Indian companies as well. Therefore, companies should start the process to assess the impact of these new standards on their financial position, performance and cash flows.

#### Uniform accounting policies vs uniform accounting estimates

Under Ind AS, the method of depreciation is treated as an accounting estimate, alignment of method of depreciation for CFS is not necessary, i.e. the method of depreciation as applied by the subsidiary is the SFS can continue to be applied in the CFS, even in cases where the such method is different from that of the parent.

In a situation, where a parent and a subsidiary have adopted different methods of depreciation, then a subsidiary can have a different method of estimating depreciation for its PPE, if its expected pattern of consumption is different. The method once selected in the SFS of the subsidiary should not be changed while preparing the CFS. (*ITFG 11, Issue 6*)

However, it is important to note that in cases, where the carrying value (as of the date of transition) as per previous GAAP has been considered as the deemed cost of the PPE, in those cases, the written down value of the assets of the subsidiary may continue to be different in the SFS of the subsidiary and the CFS of the parent.



18. Source: ICAI's publication Indian Accounting Standards (Ind AS): An Overview (Revised September 2017)

# Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance

## Key principles

- Ind AS 20 is applied in accounting for and in the disclosure of government grants and in the disclosure of other forms of government assistance.
- Government grants, including non-monetary grants at fair value, are not recognised until there is a reasonable assurance that the entity will comply with the conditions attached to them and the grants will be received.
- A forgivable loan from government is treated as a government grant when there is a reasonable assurance that the entity will meet the terms for forgiveness of the loan.
- The benefit of a government loan at a below-market rate of interest is treated as a government grant.
- A government grant which is in the form of transfer of a non-monetary asset (such as land or other resources), both the grant and asset are accounted for at fair value of the non-monetary asset.

## Recognition of government grant

- Government grants shall be recognised in profit or loss 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.
- A government grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the entity with no future related costs shall be recognised in profit or loss of the period in which it becomes receivable.

## Presentation of government grant related to assets

- Government grants related to assets, including non-monetary grants at fair value, are presented in the balance sheet by setting up the grant as deferred income.
- The grant set up as deferred income is recognised in profit or loss on a systematic basis over the useful life of the asset.

## Presentation of government grant related to income

- Grants related to income are presented as part of profit or loss, either separately or under a general heading such as 'other income' or alternatively, they are deducted in reporting the related expenses.

## Repayment of government grants

- A government grant that becomes repayable is to be accounted for as a change in accounting estimate.
- Repayment of a grant related to income shall be applied first against any unamortised deferred credit recognised in respect of the grant. To the extent that the repayment exceeds any such deferred credit, or when no deferred credit exists, the repayment is to be recognised immediately in profit or loss.
- Repayment of a grant related to an asset is to be recognised by reducing the deferred income balance by the amount repayable.
- Appendix A of Ind AS 20 prescribes that government assistance to entities meets the definition of government grants in Ind AS 20, even if there are no conditions specifically relating to the operating activities of the entity other than the requirement to operate in certain regions or industry sectors. It, in addition, provides that such grants shall not be credited directly to shareholders' interests.

### Significant differences from IFRS<sup>19</sup>

IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*, gives an option to measure non-monetary government grants either at their fair value or at nominal value. Ind AS 20 requires measurement of such grants only at their fair value. Thus, the option to measure these grants at nominal value is currently not available under Ind AS 20<sup>20</sup>.

IAS 20 gives an option to present the grants related to assets, including non-monetary grants at fair value in the balance sheet either by setting up the grant as deferred income or by deducting the grant in arriving at the carrying amount of the asset. Ind AS 20, currently requires presentation of such grants in balance sheet only by setting up the grant as deferred income<sup>20</sup>.

### Practical implications arising out of ITFG clarifications

#### Accounting treatment for grants in the nature of promoters' contribution

AS 12, *Accounting for Government Grants*, requires 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 promoter's contribution), to be credited directly to the shareholders' funds.

A government entity may have received contributions from the government in the nature of promoter's contribution, such contributions were recognised in capital reserve and treated them a part of shareholders' funds in accordance with AS 12.

At the time of transition to Ind AS, for determining the relevant accounting treatment for such grants received, it is important to ascertain whether the government has 100 per cent shareholding in the entity. The entity should first determine whether the payment received was a government grant or a shareholder's contribution. Consequently, the accounting treatment that should be applied in the two scenarios is as follows:

- In case, the entity concludes that the contribution is in the nature of a government grant, then 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.

- In case it concludes that the contribution is in the nature of 'shareholder contribution', then Ind AS 20 would not apply, since it specifically scopes out 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.

The above principles would also apply for contributions received by an entity subsequent to the Ind AS transition date. (*ITFG 9, Issue 3*)

#### Exemption of custom duty on capital goods as government grant

An entity may have received grants in the nature of exemption of custom duty on capital goods with certain conditions related to export of goods under Export Promotion Capital Goods (EPCG) scheme of Government of India.

In accordance with the guidance provided in Ind AS 20, exemption of customs duty under the EPCG scheme would be considered as a government grant. The basis for this guidance is that exemption of customs duty is considered as an assistance provided by the government in return for compliance with certain conditions relating to the operating activities of the entity and could be reliably measured.

19. Source: ICAI's publication Indian Accounting Standards (Ind AS): An Overview (Revised September 2017)

20. ED issued by the Accounting Standards Board (ASB) of the ICAI inviting comments to remove these differences. Last date for receipt of comments is 24 January 2018 and the revised standard is expected to be effective for accounting periods beginning 1 April 2018.

The accounting of such grants would be determined based on facts and circumstances of each case i.e., whether grants are related to assets or income.

Based on the evaluation of the facts and circumstances, 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 export obligation as prescribed in the EPCG scheme, then the recognition of the grant would be linked to fulfilment of the associated export obligations and would be treated as a grant related to income and such a grant will be presented in
- 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.
- *Compensates 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 treat such grant as a grant related to assets and present it as deferred income by recognising such grant in profit or loss over the life of the underlying asset. (*ITFG 11, Issue 5*)





## Ind AS 23, *Borrowing Costs*

### Key principles

- An entity is required to capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a 'qualifying asset' as part of the cost of that asset.
- A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.
- Borrowing costs include interest expense calculated using the EIR method as described in Ind AS 109, finance charges in respect of finance leases recognised in accordance with Ind AS 17 and exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.
- Borrowing costs are reduced by interest income from the temporary investment of borrowings.
- Capitalisation of borrowing costs would commence when an entity meets all of the following conditions:
  - Expenditure for the asset is being incurred
  - Borrowing costs are being incurred and
  - Activities that are necessary to prepare the asset for its intended use or sale are in progress.
- Capitalisation of borrowing costs is suspended during the period in which active development of a qualifying asset itself is suspended and altogether ceased when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

### Significant differences from IFRS<sup>21</sup>

IAS 23, *Borrowing Costs*, does not provide guidance as to how the adjustment on account of foreign exchange differences is to be determined.

However, paragraph 6(e) of Ind AS 23, provides guidance on treatment of exchange difference as borrowings cost which is given below:

- The amount of exchange loss, restricted to the extent the exchange loss does not exceed the difference between the cost of borrowing in functional currency and cost of borrowing in a foreign currency is treated as borrowing cost and
- Where there was an unrealised exchange loss which was treated as a borrowing cost in an earlier period as mentioned in point (i) above and subsequently, there is a realised or unrealised gain in respect of the settlement or translation of the same borrowing, the gain should also be recognised as an adjustment to the borrowing cost to the extent of loss previously recognised as borrowing cost.

21. Source: ICAI's publication Indian Accounting Standards (Ind AS): An Overview (Revised September 2017)

## Practical implications arising out of ITFG clarifications

### Capitalisation of Dividend Distribution Tax (DDT) paid on a preference share dividend

An entity may have issued preference shares which are classified as financial liability in accordance with Ind AS 32, *Financial Instruments: Presentation*.

In accordance with the principles laid down in Ind AS 32, interest, dividends, losses and gains relating to a financial instrument or a component that is a financial liability is to be recognised as income or expense in profit or loss.

Further, the Guidance Note on Ind AS Schedule III provides the following guidance in respect of dividend on redeemable preference shares:

‘Dividend on preference shares, whether redeemable or convertible, is of the nature of interest expense, only where there is no discretion of the issuer over the payment of such dividends. In such case, the portion of dividend as determined by applying the EIR method should be presented as interest expense under ‘finance cost’. Accordingly, the corresponding DDT on such portion of non-discretionary dividends should also be presented in the statement of profit and loss under interest expense.’

Accordingly, in this scenario, if the requirements of Ind AS 23 for capitalisation are met then the dividend on the preference shares that are classified as a liability, in accordance with the principles of Ind AS 32 would be treated as an interest and DDT paid thereon would be treated as cost eligible for capitalisation. Thus, DDT is in the nature of incremental cost that an entity incurs in connection with obtaining the funds for qualifying asset and hence, should be capitalised along with interest.

Therefore, when an entity applies the EIR method, then DDT paid on such preference dividend would form part of the EIR calculation to compute the effective interest expense to be capitalised with the qualifying asset. (*ITFG 13, Issue 1*)

### Capitalisation of processing charges to the cost of the qualifying asset

There can be instances where an entity borrows specifically for a qualifying asset and processing charges are incurred on the loan. An issue can arise whether such processing charges can be capitalised to a qualifying asset.

In accordance with the principles laid down in Ind AS 23, an entity is required to capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. Also, an entity is required to recognise other borrowing costs as an expense in the period in which it incurs them.

Additionally, Ind AS 23 states that borrowing costs include interest expense calculated using the EIR as described in Ind AS 109. Ind AS 109 defines EIR method as the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset or to the amortised cost of a financial liability.

Ind AS 109, *inter alia*, provides that in applying the EIR method, an entity identifies fees that are an integral part of the EIR of a financial instrument. Fees that are an integral part of the EIR of a financial instrument are treated as an adjustment to the EIR, unless the financial instrument is measured at fair value, with the change in fair value being recognised in profit or loss. In those cases, the fees are recognised as revenue or expense when the instrument is initially recognised.

In addition, Ind AS 109 provides examples of fees that are an integral part of the EIR of a financial instrument. Origination fees paid on issuing financial liabilities measured at amortised cost is an example of fees that is an integral part of EIR method.

Therefore, the processing fee is required to be included while calculating the EIR. Accordingly, the processing charges to the extent amortised only up to the period of capitalisation of the qualifying asset would be capitalised. (*ITFG 14, Issue 1*)

# Ind AS 24, Related Party Disclosures

## Key principles

- A related party is a person or entity that is related to the entity that is preparing its financial statements.
- Key Management Personnel (KMP) are those persons that have authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.
- KMP and their close family members are also parties related to the entity.
- Related party relationships include those involving control (direct or indirect), joint control or significant influence.
- A related party transaction is a transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged.
- Relationships between a parent and its subsidiaries shall be disclosed irrespective of whether there have been transactions between them.
- Comprehensive disclosures of related party transactions are required for each category of related party relationships.

## Significant differences from IFRS<sup>22</sup>

- In India, the accounting standards cannot override legal/regulatory requirements and therefore, disclosures which conflict with confidentiality requirements of statute/regulations are not required to be made. For example, banks are obliged by law to maintain confidentiality in respect of their customers' transactions and this standard would not override the obligation to preserve the confidentiality of their customers' dealings.
- In Ind AS 24, the 'definition of close members of the family of a person' has been amended to include brother, sister, father and mother in the category of family members who may be expected to influence, or be influenced.

## Practical implications arising out of ITFG clarifications

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

AS 18, *Related Party Disclosures*, does not include non-executive directors within the definition of 'directors'. Ind AS 24 has brought independent and non-executive directors also within its scope by including them in the definition of KMP.

In accordance with Ind AS 24, KMP includes all directors (executive or otherwise) of an entity who have 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.

In addition, 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 directors and non-executive directors would be considered as KMP under Ind AS and sitting fees paid to directors will fall under the definition of 'short-term employee benefits' in accordance with Ind AS 19. Thus, such payments are required to be disclosed in the financial statements in accordance with Ind AS 24. (*ITFG 11, Issue 9*)

### Disclosure of financial guarantee (without any fee) given by a director

(Please refer Chapter 3 on Financial Instruments for more details on accounting of financial guarantee) (*ITFG 13, Issue 2*)

22. Source: ICAI's publication Indian Accounting Standards (Ind AS): An Overview (Revised September 2017)

# Ind AS 27, Separate Financial Statements

## Key principles

- Separate Financial Statements (SFS) are financial statements presented by a parent (i.e., an investor with control of a subsidiary) or an investor with joint control of, or significant influence over, an investee, in which the investments are accounted for using the equity method<sup>23</sup>.
- When an entity prepares SFS, it is required to account for its investments in subsidiaries, joint ventures and associates either at cost, or in accordance with Ind AS 109.
- The entity is required to apply the same accounting for each category of investments.
- When investments accounted for at cost, are classified as held for sale (or included in a disposal group that is classified as held for sale), then these are required to be accounted for in accordance with Ind AS 105, *Non-current Assets Held for Sale and Discontinued Operations*.
- The measurement of investments accounted for in accordance with Ind AS 109 is not changed when these are classified as held for sale.

## Significant difference from IFRS<sup>24</sup>

IAS 27, *Separate Financial Statements*, allows the entities to use the equity method to account for investment in subsidiaries, joint ventures and associates in their SFS. This option is not permitted in Ind AS 27. It only allows cost model or Ind AS 109. The reason for not allowing equity method is that it is not a measurement basis like cost and fair value but is a manner of consolidation and therefore, would lead to inconsistent accounting conceptually.

## Practical implications arising out of ITFG clarifications

### Accounting of profit share from Limited Liability Partnerships (LLPs)

An entity may have a joint control over an LLP, which is assessed as a joint venture. The entity should account for its investment in the joint venture in its SFS in accordance with Ind AS 27, i.e. either at cost or in accordance with Ind AS 109. Therefore, an adjustment of profit share from LLP to the carrying amount of the investment in LLP in its SFS is not permitted. Accounting of return on investment (i.e. profit share from LLP) would depend on the terms of contract between the entity and LLP. The share in profit in LLP should be recognised as an income in the statement of profit and loss as and

when the right to receive its profit share is established. (*ITFG 5, Issue 8*)

Ind AS 27 does not allow entities to use the equity method to account for investment in subsidiaries, joint ventures and associates in their SFS, since the equity method is not considered a measurement basis like cost and fair value but is a manner of consolidation and therefore, would lead to inconsistent accounting conceptually.

It is relevant to note that from the accounting period beginning 1 January 2016, IAS 27 permits an entity to apply equity method to account for investment in subsidiaries, joint ventures and associates in their SFS. However, Ind AS 27 does not permits equity accounting in SFS.

23. In accordance with Ind AS 28, under the equity method, on initial recognition, the investment in an associate or a joint venture is recognised at cost and the carrying amount is increased or decreased to recognise the investor's share of the profit or loss of the investee after the date of acquisition.

Ind AS 28 also provides that the investor's share of the investee's profit or loss is recognised in the investor's profit or loss. Distributions received from an investee reduce the carrying amount of the investment.

24. Source: ICAI's publication Indian Accounting Standards (Ind AS): An Overview (Revised September 2017)

### Deemed cost of an investment in a subsidiary

An entity may elect to apply the deemed cost exemption on transition to Ind AS and accordingly measure its investment in its subsidiary at its fair value on the date of transition. Ind AS 27 permits such an entity to measure its investment in its subsidiary at either its cost or in accordance with Ind AS 109 (i.e. at fair value) in its SFS. An entity may have used fair value as the measurement basis for the deemed cost on transition. Post transition, the entity would continue to carry its investment in the subsidiary at the transition date fair value, which is deemed to be its cost under Ind AS. *(ITFG 3, Issue 12)*

(Please refer the Chapter 9 on First time Adoption of Ind AS for more details on deemed cost of an investment in a subsidiary) *(ITFG 3, Issue 12)*

### Investments in debentures of a subsidiary company

Parent companies may often invest in the debentures of its subsidiary companies. Such investments may be in addition to their investment in respective shares of subsidiary. Practical implications arise regarding accounting of such investments under the provisions of Ind AS 27 and the consequent exemptions in paragraph D15 of Ind AS 101 at the time of transition to Ind AS.

It is noteworthy that Ind AS 10 is not applicable to interest in subsidiaries, associates and joint ventures that are accounted for in accordance with Ind AS 110, Ind AS 27 or Ind AS 28.

As explained earlier, Ind AS 27 permits an entity to account for its investments in subsidiaries, associates or joint ventures either at cost or in accordance with Ind AS 109 in its SFS. In addition, paragraph D15 of Ind AS 101 provides an exemption to measure the cost of such an investment at either the cost determined in accordance with Ind AS 27 or at a 'deemed cost' based on its fair value at the date of transition to Ind AS or its previous GAAP carrying amount.

However, such requirements of Ind AS 27 and the exemption in Ind AS 101 would only apply to those investments in a subsidiary, which meets the definition of an equity instruments under Ind AS 32 (from the issuer, i.e., the subsidiary's perspective). Hence, if the debentures are classified as a financial liability by the subsidiary, the holding company would have to classify its investment as a financial asset and account for it under Ind AS 109. *(ITFG 7, Issue 8)*

### Measurement of investment in subsidiaries, joint ventures and associates at the end of the first Ind AS financial reporting period

(Please refer Chapter 9 on First time Adoption of Ind AS for more details on measurement of investment in subsidiary, associates and joint ventures) *(ITFG 11, Issue 4)*





# Ind AS 33, *Earnings per Share*

## Key principles

- Basic Earnings Per Share (EPS) is calculated by dividing profit or loss attributable to holders of ordinary equity of the parent (the numerator) by the weighted average number of ordinary shares outstanding (the denominator) during the period.
- Where any item of income or expense which is otherwise required to be recognised in profit or loss in accordance with Ind AS is debited or credited to securities premium account/other reserves, the amount in respect thereof is required to be deducted from profit or loss from continuing operations for the purpose of calculating basic EPS.
- Diluted EPS is calculated by adjusting profit or loss attributable to holders of the ordinary equity of the parent, and the weighted average number of shares outstanding, for the effects of all dilutive potential ordinary shares.
- Potential ordinary shares shall be treated as dilutive when, and only when, their conversion to ordinary shares would decrease EPS or increase loss per share from continuing operations.
- If the number of ordinary or potential ordinary shares outstanding increases as a result of a capitalisation, bonus issue or share split, or decreases as a result of a reverse share split, the calculation of basic and diluted EPS for all periods presented shall be adjusted retrospectively.
- If these changes occur after the reporting period but before the financial statements are approved for issue, the per share calculations for those and any prior period financial statements presented shall be based on the new number of shares.
- Basic and diluted EPS for profit or loss from continuing operations and profit or loss for the period for each class of ordinary shares that has a different right to share in profit for the period, is required to be presented in statement of profit and loss with equal prominence for all periods presented.
- An entity that reports a discontinued operation shall disclose the basic and diluted amounts per share for the discontinued operation either in the statement of profit and loss or in the notes.
- When an entity presents both CFS and SFS in accordance with Ind AS 110 and Ind AS 27 respectively, the disclosures required are to be presented both in the CFS and SFS. In CFS, such disclosures shall be based on consolidated information and in SFS, such disclosures shall be based on information given in SFS. An entity is prohibited from presenting EPS in CFS based on the information given in SFS and *vice versa*.

## Significant differences from IFRS<sup>25</sup>

- IAS 33, *Earnings Per Share*, provides that when an entity presents both CFS and SFS, it may give EPS related information in CFS only, whereas, Ind AS 33 requires EPS related information to be disclosed both in CFS as well as SFS.
- In India, the 2013 Act, requires preparation and presentation of both CFS as well as SFS and consequently, for listed entities, EPS is required to be disclosed both in CFS as well as SFS. In addition, such disclosures are required to be in accordance with the information contained in the respective financial statements i.e. in CFS, EPS is to be disclosed based on consolidated information while in case of SFS, it is to be disclosed for information contained in such SFS only.
- The applicability or exemptions to the Ind AS are governed by the 2013 Act and the Rules made there under and consequently Ind AS 33 has been modified to that extent.
- In Ind AS 33, paragraph 15 has been amended by adding the phrase, 'irrespective of whether such discount or premium is debited or credited to securities premium account' to further clarify that such discount or premium shall also be amortised to retained earnings.

25. Source: ICAI's publication Indian Accounting Standards (Ind AS): An Overview (Revised September 2017)

## Practical implications arising out of ITFG clarifications

### Consideration of amounts debited to Foreign Currency Monetary Item Translation Difference Account (FCMITDA) for computation of basic EPS

A company may have availed the option given under paragraph D13AA of Ind AS 101. This means, that it continued to apply the accounting treatment permitted by paragraph 46/46A of AS 11, *The Effects of Changes in Foreign Exchange Rates*. Accordingly, the company has accumulated such exchange gains/losses in the reserve FCMITDA.

Ind AS 33 refers to items of income and expenses which are required by Ind AS to be recognised in the statement of profit and loss, but have been debited or credited to securities premium/other reserves and requires these to be added to/deducted from profit or loss from continuing operations for computing the basic EPS.

In this context, accumulation of the exchange differences arising from translation of long term foreign currency monetary items in FCMITDA is permitted under the optional exemption available in Ind AS 101. Therefore, such exchange differences are not required to be reduced from profit or loss from continuing operations for the purpose of calculating basic EPS. (*ITFG 10, Issue 5*)

### Calculation of EPS by a subsidiary company that is not wholly owned by its parent

Ind AS 33, *inter alia*, states that an entity shall calculate basic EPS for profit or loss attributable to ordinary equity shareholders of the parent entity. These requirements in Ind AS 33 have been provided with respect to the calculation of EPS in the CFS of an entity. Accordingly, a subsidiary company, which is not fully owned by its parent should calculate and disclose its basic EPS as follows:

- **SFS:** In case of SFS, the 'parent entity' mentioned in relevant paragraph will imply the legal entity of which SFS are being prepared. Accordingly, when an entity presents basic EPS in its SFS, then the same shall be calculated based on the profit or loss attributable to its equity shareholders.
- **CFS:** For the purpose of calculating EPS based on CFS, the company 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 (NCI). (*ITFG 11, Issue 3*)



# Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets

## Key principles

- A provision is a liability of uncertain timing and amount that arises from a past event that is expected to result in an outflow of the entity's resources.
- A provision is recognised for a legal or constructive obligation if there is a probable outflow of resources and the amount can be estimated reliably. Probable, in this context, means likely than not.
- A constructive obligation arises when an entity's actions create valid expectations of third parties that it will accept and discharge certain responsibilities.
- A provision is measured at the best estimate of the expenditure to be incurred.
- A provision is not recognised for future operating losses.
- A provision is required for a contract that is onerous.
- A provision for restructuring costs is recognised only when the general recognition criteria for provisions are met.
- Contingent liabilities are recognised only if they are present obligations assumed in a business combination i.e. there is uncertainty about the outflows but not about the existence of an obligation.
- Contingent assets are not recognised in the balance sheet. If an inflow of economic benefits is probable, then details are disclosed in the notes to the financial statements.

## Practical implications arising out of ITFG clarifications

### Provision for unspent Corporate Social Responsibility (CSR) expenditure

Section 135(5) of the 2013 Act (including the Companies Amendment Act, 2017) provides that every company with net worth of INR500 crore or more, or turnover of INR1,000 crore or more or a net profit of INR5 crore or more during the immediately preceding financial year should contribute at least two per cent of its average net profits (made during the three immediately preceding financial years) towards CSR. However, in case a company fails to spend the amount earmarked for CSR, then the reasons for not spending the amount is required to be disclosed in the board's report.

A company may be unable to spend the CSR amount i.e. there is a shortfall in the amount that was expected to be spent as per the provisions of the 2013 Act on CSR activities and the amount actually spent at the end of a reporting period. In this case, the company may not be required to recognise a provision for the unspent amount in the financial statements.

However, if a company has already undertaken certain CSR activity for which an obligation has been created, for example, through a contractual obligation, or either a constructive obligation has arisen during the year, then in accordance with Ind AS 37, a provision for the amount of such CSR obligation, needs to be recognised in the financial statements. (*ITFG 8, Issue 1*)

# Ind AS 108, *Operating Segments*

## Key principles

- Ind AS 108 applies to entities to which Ind AS apply as notified under the 2013 Act. It is primarily a disclosure standard.
- Its core principle is that an entity is required to disclose information to enable users of its financial statements to evaluate the nature and the financial effects of the business activities in which it engages and the economic environment in which it operates.
- If a financial report contains both the CFS of a parent that is within the scope of this Ind AS as well as the parent's SFS, segment information is required only in the CFS.
- Operating segments are components of an entity about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance.
- Generally, financial information is required to be reported on the same basis as is used internally for evaluating operating segment performance and deciding how to allocate resources to operating segments.
- It requires an entity to report a measure of operating segment profit or loss and of segment assets. It also requires an entity to report a measure of segment liabilities and particular income and expense items if such measures are regularly provided to the chief operating decision maker.
- It requires reconciliations of total reportable segment revenues, total profit or loss, total assets, liabilities and other amounts disclosed for reportable segments to corresponding amounts in the entity's financial statements.
- It requires an entity to report information about the revenues derived from its products or services (or groups of similar products and services), about the countries in which it earns revenues and holds assets, and about major customers, regardless of whether that information is used by management in making operating decisions.
- An entity is also required to give descriptive information about the way the operating segments were determined, the products and services provided by the segments, differences between the measurements used in reporting segment information and those used in the entity's financial statements and changes in the measurement of segment amounts from period to period.

## Significant differences from IFRS<sup>26</sup>

IFRS 8, *Operating Segments*, requires that it is applied to the separate or individual financial statements of an entity as well as the CFS of a group with a parent:

- Whose debt or equity instruments are traded in public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets) or
- That files, or is in the process of filing its financial statements or CFS with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market.

However, the applicability and exemptions to the Ind AS are governed under the 2013 Act and the Rules made thereunder. Consequently, Ind AS 108 does not include the above applicability requirements as included in IFRS 8.

26. Source: ICAI's publication Indian Accounting Standards (Ind AS): An Overview (Revised September 2017)

## Practical implications arising out of ITFG clarifications

### Information about major customers where an entity operates only in one segment

Ind AS 108 is applicable to entities to which Ind AS applies. According to Ind AS 108, an entity is required to provide information about the extent of its reliance on its major customers. If revenues from transactions with a single external customer amount to 10 per cent or more of an entity's revenues, the entity should disclose that fact, the total amount of revenues from each such customer, and the identity of the segment or segments reporting the revenues. The entity need not disclose the

identity of a major customer or the amount of revenues that each segment reports from that customer.

The ITFG clarified that the disclosure requirements as specified in paragraphs 32-34 of Ind AS 108 apply to all entities to which Ind AS applies including entities that have a single reportable segment.

Therefore, in the case of single reportable segment companies, information regarding customers contributing to more than 10 per cent of total revenue would have to be disclosed. However, the entity need not disclose the identity of a major customer or customers, or the amount of revenues that each segment reports from that customer or those customers. (*ITFG 13, Issue 3*)





# Applicability of Ind AS

The ITFG has dealt with a number of issues regarding applicability based on Ind AS road map. Some of the relevant principles opined by ITFG are included in this section.

## Practical implications arising out of ITFG clarifications

### Applicability in case of net worth

Once a company meets the threshold criteria it is then required to comply with the Ind AS road map irrespective of the fact that its net worth falls below the criteria specified at a later date. In a situation relating to a debt-listed company, where the company met the net worth criterion on 31 March 2014 (i.e. met the net worth criteria for phase I of road map). Later the net worth of the company falls below the specified threshold. Accordingly, the net worth of the company should be calculated in accordance with the SFS of the company as on 31 March 2014 (i.e. when the road map for phase I companies became applicable in the instant case). (*ITFG 6, Issue 1*).

A company could fall in the Ind AS road map when it meets the listing criteria. If a company ceased to meet the listing criteria in Ind AS road map immediately before the mandatory Ind AS application date, then it would not be required to comply with Ind AS even if met the criteria on a prior date. (*ITFG 3, Issue 8*)

### Capital reserve in the nature of promoter's contribution

An entity may have received grant from government, in the nature of promoter's contribution which was included in capital reserve in accordance with the provisions of AS 12, *Accounting for Government Grants*. Such capital reserve (in the nature of promoter's contribution) should be included as a part of net worth only for the purpose of Ind AS applicability.

In addition, definition of net worth for Ind AS applicability should not be applied by analogy for determining net worth under other provisions of the 2013 Act. (*ITFG 6, Issue 4*)

### Employees Stock Option Plan (ESOP) reserve in computation of net worth

In order to compute net worth for Ind AS applicability, ESOP reserve is required to be included. The ITFG

considered the Guidance Note on Accounting for Employee Share-based Payments which, *inter alia*, provided that an enterprise should recognise as an expense (except where service received qualifies to be included as a part of the cost of an asset) the services received in an equity-settled employee share-based payment plan when it receives the services, with a corresponding credit to an appropriate equity account, say, 'Stock Options Outstanding Account'. This account is transitional in nature as it gets ultimately transferred to another equity account such as share capital, securities premium account and/or general reserve as recommended in the subsequent paragraphs of this Guidance Note.

In addition, the definition of net worth for Ind AS applicability should not be applied by analogy for determining net worth under other provisions of the 2013 Act. (*ITFG 11, Issue 1*)

### Applicability of Ind AS to a branch of a company incorporated outside India

A company incorporated outside India with limited liability, may have established a branch office in India, with the permission of the Reserve Bank of India (RBI), to provide consultancy services in India. Ind AS road map is applicable to a company as defined in section 2(20) of the 2013 Act. According to the definition, a company means a company incorporated under the 2013 Act or under any previous company law. A branch office of a foreign company established in India does not meet the definition of a company under the 2013 Act. Hence, Ind AS road map is not applicable to a branch of a company not incorporated in India. (*ITFG 12 Issue 6*)

### Applicability of Ind AS road map to an NBFC performing such a role but not yet registered with the RBI

A company, awaiting its registration as a Non-Banking Financial Company (NBFC) with the RBI, may in the meanwhile, be performing the role of NBFC. The definition of an NBFC included in the Rule 4(1) (iii) of the Companies (Indian Accounting Standards) (Amendments) Rules, 2016, laying down the road map for the applicability of Ind AS to NBFCs is very wide.

It covers a company which is carrying on the activity of NBFC. Accordingly, a company which is carrying on the activity of NBFC but not registered with RBI would also be subject to the road map for the applicability of Ind AS as applicable to any other NBFC. However, the requirements with regard to registration, eligibility of a

company to operate as an NBFC (pending registration) etc, are governed by the RBI Act, 1934, and the Rules laid down thereon and should be evaluated by the company based on its own facts and circumstances separately. *(ITFG 13, Issue 4)*

### Consider this

The ITFG and ICAI (in its frequently asked questions considered in this publication) dealt with various issues and fact patterns. In certain cases, the fact pattern could be very specific to an entity and in other cases, they may involve a considerable amount of judgement and evaluation of facts and circumstances. Accordingly, in those cases, ITFG and ICAI may have provided a list of indicative factors to be considered by the issuers of the financial statements.

Based on our analysis of the topics dealt by the ITFG and ICAI, we believe that there are certain issues that would require entities to apply judgement while accounting in following scenarios:

1. Determination of an acquisition date in a business combination when a scheme is filed with NCLT (both under common control and outside common control situations). *(ITFG 12, Issue 8)*
2. Determination of whether an approved appointed date by NCLT to be accounted as an adjusting event while preparing financial statements. *(ITFG 14, Issue 4)*
3. Classification of lease of land into operating or financing lease. *(ITFG 7, Issue 5)*
4. Accounting of deferred taxes on freehold land. *(ITFG 7, Issue 7)*
5. Accounting of deferred taxes on undistributed profits in the CFS when a subsidiary (wholly or partly owned) declares dividend. *(ITFG 9, Issue 1 and ITFG 13, Issue 9)*
6. Determination of whether lease rent escalation is linked to inflation. *(ITFG 5, Issue 7)*
7. Determination of amortisation period of processing fees related to undisbursed loans. *(ITFG 10, Issue 2)*
8. Applicability of hedge accounting to long term foreign currency monetary items, where foreign exchange differences continue to be capitalised to the cost of a related asset. *(ITFG 3, Issue 10)*
9. On first- time adoption of Ind AS, certain adjustments are recognised in retained earnings. There is uncertainty whether such adjustments would be considered as part of free reserves.
10. On first-time adoption, an entity may select previous GAAP carrying values as deemed cost for its PPE. In certain areas, this deemed cost can be adjusted due to consequential adjustments required by other Ind AS. This issue has to be dealt with on a case to case basis.
11. Determination of security deposits accepted by the utility companies are current or non-current liability.
12. Determination of government grant (whether related to asset or income) in relation to exemption of customs duty on capital goods. *(ITFG 11, Issue 5)*
13. For foreign currency borrowings, whether an entity can recognise the impact of foreign exchange differences (arising from derivatives used to hedge the foreign currency interest expense) as an adjustment to borrowing costs. This issue arises by applying analogy to recognition of DDT on preference shares dividend as an adjustment to EIR for determining the borrowing costs. *(ITFG 13, Issue 1)*

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## IFRS Notes

### Ind AS Transition Facilitation Group (ITFG) issues Clarifications Bulletin 13

2 February 2018



#### Background

With Indian Accounting Standards (Ind AS) being applicable to corporates in a phased manner 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 (Ind AS Rules).

Since then, ITFG issued 12 bulletins to provide guidance on issues relating to the application of Ind AS.

#### New development

The ITFG in its meeting considered certain issues received from the members of the ICAI and issued its Clarification Bulletin 13 on 16 January 2018 to provide clarifications on 10 issues in relation to the application of Ind AS.

This issue of IFRS Notes provides an overview of the clarifications issued by ITFG through its Bulletin 13.

## First Notes

### SEBI relaxes norms governing schemes of arrangements by listed entities

18 January 2018



#### Background

The listed entities that desire to undertake a scheme of arrangement or are involved in a scheme of arrangement need to follow the regulations laid down by the Securities and Exchange Board of India (SEBI). On 10 March 2017, SEBI issued a circular number CFD/DIL3/CIR/2017/21

which laid down a revised regulatory framework for schemes of arrangements by listed entities and relaxation under Rule 19(7) of the Securities Contract (Regulation) Rules, 1957.

#### New development

The SEBI received representations to improve the existing framework governing schemes of arrangements.

Additionally, SEBI wanted to expedite the processing of draft schemes and prevent misuse of schemes to bypass regulatory requirements. Therefore, on 3 January 2018, SEBI issued a circular number CFD/DIL3/CIR/2018/2 (the circular) to make certain amendments to the circular dated 10 March 2017.

The recent circular is applicable from the date of its issue i.e. 3 January 2018. Some of the key relaxations provided in the circular relate to the following topics:

- Submission of documents to stock exchanges
- Relaxations with respect to locked-in promoter's shares
- Extended time period for listing of specified securities.

In this issue of First Notes, we have provided an overview of the key amendments/relaxations given in the circular.



### Voices on Reporting – Webinar

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.

The new revenue standard (Ind AS 115, *Revenue from Contracts with Customers*) is expected to be applicable to Indian companies following the Ind AS road map framework from 1 April 2018.

Starting from January 2018, the Voices on Reporting presents a series of special sessions to discuss insights on Ind AS 115.

In the first session of Ind AS 115 series held on 17 January 2018, we discussed the key requirements of Ind AS 115, transition and key impact areas.

## Introducing



# 'Ask a question'

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