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First Notes

MCA issues narrow scope amendments to Indian Accounting Standards

5 May 2022

First Notes on

Financial reporting

Corporate law updates

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Disclosures

Sector

All

Banking and insurance

Information, communication, entertainment

Consumer and industrial markets

Infrastructure and government

Relevant to

All

Audit committee

CFO

Others

Transition

Immediately

Within the next three months

Post three months but within six months

Post six months

Forthcoming requirement

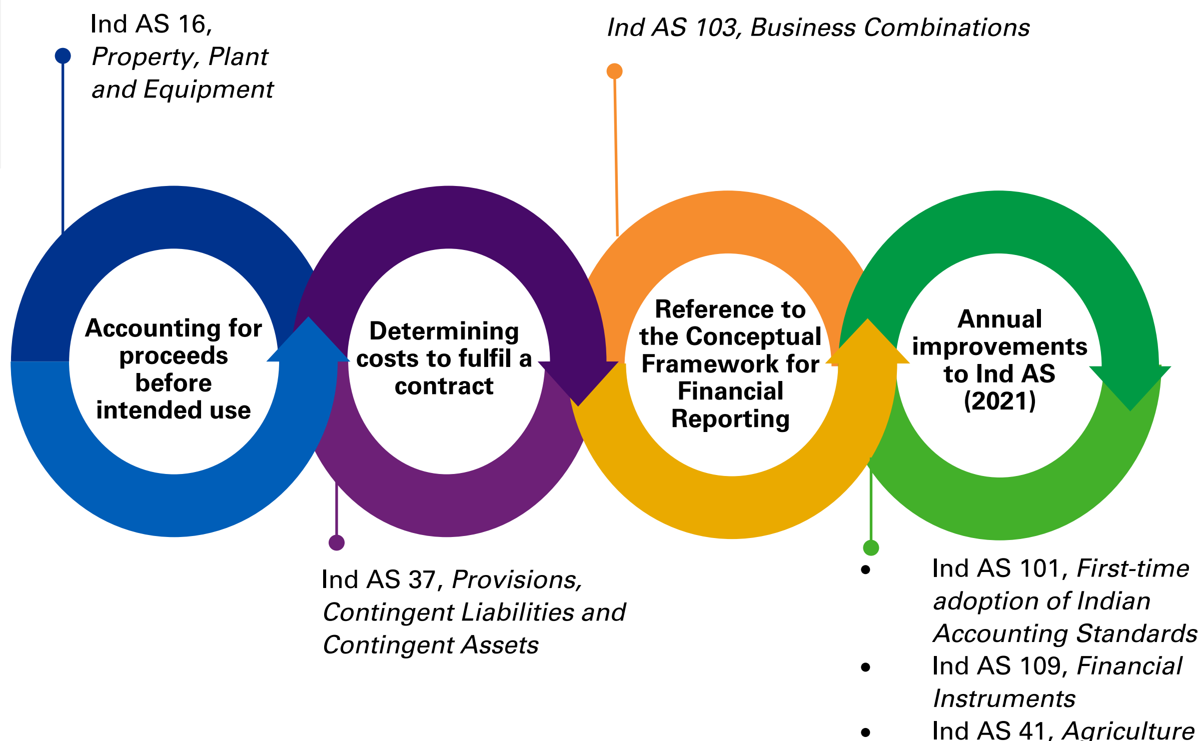
Introduction

Indian Accounting Standards (Ind AS) are largely converged with the International Financial Reporting Standard (IFRS) issued by the International Accounting Standards Board (IASB). In the recent past, IASB along with the IFRS Interpretations Committee (IFRIC) has issued various amendments to IFRS as part of their annual improvements process or as specific narrow scope amendments.

In view of the recent amendments to IFRS, and in order to keep the Ind AS converged with IFRS[1], the Ministry of Corporate Affairs (MCA) issued certain amendments to Ind AS[2] vide a notification dated 23 March 2022 (2022 amendments). These amendments have been issued in the areas mentioned in figure 1 below.

This issue of first notes aims to provide an overview of the 2022 amendments.

Figure 1: Areas in which amendments have been issued by the 2022 amendments



(Source: KPMG in India's analysis, 2022 read with the 2022 amendments)

[1] While most of the amendments to Ind AS are in line with those prescribed for IFRS, MCA issued a carve out for Ind AS 16, *Property, Plant and Equipment*

[2] Amendments to Ind AS were issued through the Companies (Indian Accounting Standards) Amendment Rules, 2022

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Overview of amendments

Accounting for proceeds before intended use (*Ind AS 16, Property, Plant and Equipment)*

Background

As per Ind AS 16, cost of Property, Plant and Equipment (PPE) comprises:

- **Purchase price:** Purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates
- **Directly attributable costs:** Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management
- **Costs of dismantling:** Initial estimate of costs of dismantling and removing the item and restoring the site on which it is located.

Ind AS 16 further provides examples of directly attributable costs, which *inter alia* include 'cost of testing' whether the asset is functioning properly, post deduction of net proceeds from the sale of items produced while bringing the asset to its required location and intended condition (net sale proceeds of items produced).

Amendment

The 2022 amendments have clarified the accounting treatment for 'excess of net sale proceeds of items produced over the cost of testing'. As per the 2022 amendments, the excess of net sale proceeds of items produced over the cost of testing, if any, **should not be** recognised in the statement of profit or loss **but deducted from the directly attributable costs considered as part of cost of an item of PPE**.

Effective date

The amendments are effective for annual reporting periods beginning on or after 1 April 2022.

Determining costs to fulfil a contract (Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets*)

Background

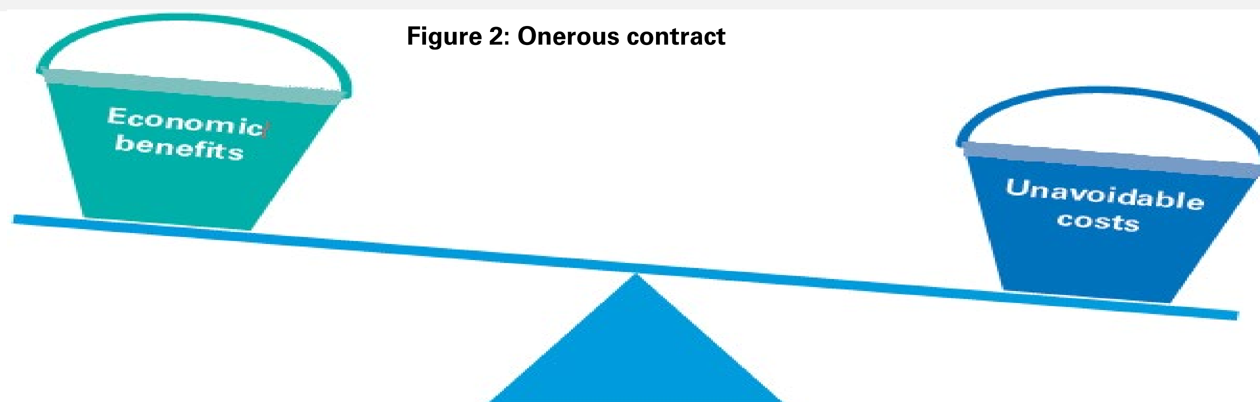
Ind AS 37 defines an onerous contract as under:

A contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it (see figure 2 below).

The unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of:

- the cost of fulfilling the contract and
- any compensation or penalties arising from failure to fulfil it (costs of terminating the contract).

Figure 2: Onerous contract



(Source: Assessing if a contract is onerous, issued by KPMG IFRG Limited, 14 May 2020)

However, Ind AS 37 did not explain the items of cost that should comprise 'cost of fulfilling a contract'.

Amendment

The 2022 amendments clarify the types of costs a company can include as the 'costs of fulfilling a contract' while assessing whether a contract is onerous as under:

- The incremental costs of fulfilling that contract—for example, direct labour and materials; and
- An allocation of other costs that relate directly to fulfilling contracts— for example, an allocation of the depreciation charge for an item of PPE used in fulfilling that contract.

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Interaction with requirements for impairment of assets: Prior to the 2022 amendments, paragraph 69 of Ind AS 37, stated that before establishing an onerous contract provision, entities should recognise an impairment loss that has occurred on assets ***dedicated to that contract***. However, the term dedicated could be read to apply only to assets used solely on that contract and not used on other contracts.

Amendment

The terminology in paragraph 69 has been amended and the term 'dedicated to that contract' has been replaced to 'used in fulfilling the contract'. This amendment clarifies that the requirement to recognise any impairment loss before establishing an onerous contract provision applies to **all assets** whose cost would be considered in assessing whether the contract is onerous.

Effective date and transition

The amendments apply for annual reporting periods beginning on or after 1 April 2022 to contracts existing at the date when the amendments are first applied.

At the date of initial application, the cumulative effect of initially applying the amendments is recognised as an opening balance adjustment to retained earnings or other component of equity, as appropriate. The comparatives are not required to be restated.

Reference to the Conceptual Framework for Financial Reporting (Ind AS 103, *Business Combinations*)

Background

In March 2018, the IASB issued a revised version of its Conceptual Framework for Financial Reporting. In view of this revision by IASB, and with an objective to remain converged with the global accounting framework, in August 2020, the Institute of Chartered Accountants of India (ICAI) developed the Conceptual Framework for Financial Reporting (the Conceptual Framework) under Ind AS[3], which corresponds to IASB's revised Conceptual Framework for Financial Reporting, 2018.

Prior to the 2022 amendments, para 11 of Ind AS 103 stated, that to qualify for recognition as part of applying the acquisition method, the identifiable assets acquired and liabilities assumed should meet the definitions of assets and liabilities in the *Framework for Preparation and Presentation of Financial Statements with Indian Accounting Standards* at the acquisition date.

Amendment

The 2022 amendments have substituted the reference to the *Framework for Preparation and Presentation of Financial Statements with Indian Accounting Standards* with the reference to the ***Conceptual Framework for Financial Reporting under Indian Accounting Standards (Conceptual Framework),*** without changing the accounting requirements for business combinations.

Reference to Ind AS 37: Due to substitution of reference to the Conceptual Framework, there were certain accounting implications to contingent liabilities and levies within the scope of Ind AS 37 and Appendix C, *Levies*.

The implication is that assets and liabilities in a business combination are recognised if they meet the definition of an asset or a liability as per the Conceptual Framework. The timing of recognition of a levy could be different due to specific guidance given in Appendix C. Therefore, while recognising levies at the acquisition date, an acquirer might recognise at the acquisition date a liability to pay a levy that it would not recognise subsequently when applying Appendix C, Levies. This difference would arise because an entity might recognise a liability earlier by applying the Conceptual Framework. This liability would be derecognised immediately afterwards when principles of Appendix C are applied and the entity would recognise a so-called Day 2 gain.

Therefore, to resolve this implications, Ind AS 103 has been amended with regards to recognition exception for contingent liabilities and levies. An exception has been added to the requirements of paragraph 11 of Ind AS 103 for liabilities and contingent liabilities that would be within the scope of Ind AS 37 or Appendix C if incurred separately, rather than assumed in a business combination.

Contingent asset: Ind AS 103 prohibited the recognition of contingent assets even prior to the 2022 amendments, however, this prohibition was not stated explicitly in Ind AS 103 itself. A paragraph 23A has been added to Ind AS 103 to make its requirements for contingent assets explicit and clarify that replacing the reference to the Conceptual Framework does not change its principles.

Effective date and transition

The 2022 amendments would be applicable to those business combinations for which the acquisition date is on or after 1 April 2022.

[3] Earlier, the ICAI had issued the 'Framework for Preparation and Presentation of Financial Statements under Indian Accounting Standards'.

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Annual improvements to Ind AS (2021)

Annual improvements provide a mechanism for dealing efficiently with a collection of minor amendments to Ind AS. The following table shows the Ind AS amended and the subject of the proposed amendments. These amendments are effective from financial years beginning on or after 1 April 2022.

Standard	Subject of amendment
Ind AS 101, *First-time Adoption of Indian Accounting Standards*	Subsidiary as a first-time adopter of Ind AS
Ind AS 109, *Financial Instruments*	Fees in the ’10 per cent’ test for derecognition of financial liabilities
Ind AS 41, *Agriculture*	Taxation in fair value measurements

Subsidiary as a first-time adopter of Ind AS (Ind AS 101, *First-time Adoption of Indian Accounting Standards*)

The 2022 amendments aim to simplify the application of Ind AS 101 for a subsidiary that becomes a first-time adopter of Indian Accounting Standards (Ind AS) later than its parent.

Background

As per Ind AS 21, *The Effects of Changes in Foreign Exchange Rates*, entities are required to recognise foreign currency translation differences in Other Comprehensive Income (OCI) and accumulate these in a separate component of equity. Paragraph D13 of Ind AS 101 provides an exemption to a first-time adopter of Ind AS with regard to cumulative translation differences on the date of transition to Ind AS. First-time adopters of Ind AS are permitted to deem all cumulative translation differences for all foreign operations to be zero on the date of the transition to Ind AS.

Amendment

As per the 2022 amendments, if a subsidiary, joint venture of associate (together termed as subsidiary) adopts Ind AS later than its parent and applies paragraph D16(a) of Ind AS 101[4], then the subsidiary may elect to measure cumulative translation differences for all foreign operations at amounts included in the consolidated financial statements of the parent, based on the parent’s date of transitions to Ind AS.

Rationale for amendment

While paragraph D16(a) of Ind AS 101 provides exemptions for measurement of assets and liabilities, however, these exemptions did not apply to components of equity. As a result, the subsidiary would have to maintain two parallel sets of accounting records for cumulative translation differences based on different dates of transition to Ind AS. With this amendment, subsidiaries may choose to measure their cumulative translation differences at amounts included in the consolidated financial statements of the parent.

Fees in the ’10 per cent test’ for derecognition of financial liabilities (Ind AS 109, *Financial Instruments*)

Background

As per Ind AS 109, a financial liability is derecognised when it is extinguished, which may *inter alia* happen when there is an exchange between an existing borrower and lender of debt instruments with substantially different terms or a substantial modification of the terms of an existing debt instrument (modification of terms). In such a case, the original financial liability is derecognised and a new financial liability is recognised (with the revised terms).

Ind AS 109 further clarifies that terms are considered to have been substantially modified when the net present value of the cash flows under the new terms, including any **fees paid net of any fees received** and discounted using the original effective interest rate – i.e. of the original debt instrument – differs by at least 10 percent from the present value of the remaining cash flows under the original terms (the ’10 percent test’).

Ind AS 109 did not define the term ‘fees’ in the context of performing the 10 per cent test.

Amendment

The 2022 amendment clarifies that for the purpose of performing the ’10 per cent test’ for derecognition of financial liabilities, in determining fees paid, the borrower includes amounts paid by the borrower to or on behalf of the lender, and fees received include amounts paid by the lender to or on behalf of the borrower.

Transition

The amendment is applied **prospectively** to modifications and exchanges that occur on or after the date the entity first applies the amendment.

[4] Paragraph D16 of Ind AS 101 provides exemption to subsidiaries who become a first-time adopter of Ind AS later than its parent company (first-time adopter subsidiaries) with regard to measurement of assets and liabilities. As per paragraph D16(a), in certain cases, first-time adopter subsidiaries can measure their assets and liabilities at the carrying amounts that would be included in the parent’s consolidated financial statements, based on the parent’s date of transition to Ind AS.

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Ind AS 41, *Agriculture*

Background

Ind AS 41 requires biological assets to be measured on initial recognition and at the end of each reporting period at its fair value less costs to sell.

Para 22 of Ind AS 41 prescribes the cash flows that would **not** be considered for the purpose of assessing the fair value. These cash flows include:

- Cash flows for financing the assets
- Cash flows for taxation, and
- Cash flows for re-establishing biological assets after harvest.

Amendment

Previously the requirement to use a pre-tax discount rate when measuring fair value was removed from Ind AS 41, however the requirement to use pre-tax cash flows when measuring fair value was not removed from the standard.

In order to ensure a consistent approach regarding cash flows and discount rates, the 2022 amendments have removed the requirement to exclude cash flows for taxation when measuring fair value, thereby aligning the fair value measurement requirements in Ind AS 41 with those in Ind AS 113, *Fair Value Measurement*.

Our comments

The 2022 amendments have introduced narrow scope amendments to Ind AS in order to provide clarifications on various provisions pertaining to accounting. All amendments are effective 1 April 2022, therefore entities should consider the impact of these amendments in terms of paragraphs 30 and 31[5] of Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors* while finalising the financial statements for the year ended 31 March 2022.

Accounting for proceeds before intended use of PPE – a carve out from IFRS

- During the process of making an item of PPE available for its intended use, a company may produce and sell items e.g. minerals extracted in the process of constructing an underground mine or oil and gas from testing wells before starting production. The amendments issued by MCA have reiterated that the net sale proceeds of such items produced while the PPE is brought to its designated location and intended condition (net of cost of testing) would be deducted from the directly attributable costs considered as part of cost of PPE.
- In May 2020, the IASB had issued amendments to IAS 16, *Property, Plant and Equipment*, clarifying the treatment of net sale proceeds of items produced. Under the amendments issued by IASB, proceeds from selling items before the related item of PPE is available for use **should be recognised in the statement of profit or loss**, together with the costs of producing those items. Further, IAS 2 *Inventories,* would be applied in identifying and measuring production costs. IASB has provided clarifications to the meaning of 'testing the functioning of PPE' and has also prescribed additional **disclosures.**

  However, similar amendments have not been made in Ind AS 16. The amendments to Ind AS 16 clarify that excess of net sale proceeds of items produced over the cost of testing, if any, should not be recognised in the statement of profit or loss but deducted from the directly attributable costs considered as part of cost of an item of PPE.

  Accordingly, entities that are required to maintain books of account in accordance with IFRS for the purpose of consolidation, should take note of this carve out from IFRS. Consequently, separate registers for PPE would be required to be maintained as per the provisions of Ind AS and that as per IFRS, which will result in a different amount of depreciation being charged on an annual basis to the statement of profit or loss under Ind AS and IFRS respectively.

[5] As per paragraph 30 of Ind AS 8, when an entity has not applied a new Ind AS that has been issued but is not yet effective, the entity shall disclose:

a. this fact; and
b. 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.

As per para 31 of Ind AS 8, in complying with paragraph 30, an entity considers disclosing:

a. the title of the new Ind AS;
b. the nature of the impending change or changes in accounting policy;
c. the date by which application of the Ind AS is required;
d. the date as at which it plans to apply the Ind AS initially; and
e. either:
   i. a discussion of the impact that initial application of the Ind AS is expected to have on the entity's financial statements; or
   ii. if that impact is not known or reasonably estimable, a statement to that effect.

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Our comments (contd.)

Cost of fulfilling a contract

- **Full cost approach**: Following the withdrawal of Ind AS 11, *Construction Contracts*, companies apply the requirements in Ind AS 37 when determining whether a contract is onerous. Previously Ind AS 11 specified which costs were included as a cost of fulfilling a contract, however the same clarity was not provided by Ind AS 37. This led to diversity in practice and two approaches developed:
  - the 'incremental cost' approach and
  - the 'full cost' approach

  The 'full cost' approach includes both the incremental costs of the contract (e.g. direct materials and labor) and an allocation of other costs incurred to fulfil the agreement (e.g. allocated depreciation, other shared costs).

  The clarifications issued by the 2022 amendments state that 'costs of fulfilling a contract' comprises of both, the incremental costs as well as an allocation of other direct costs (see figure 3 below). Therefore, companies that are currently applying the 'incremental cost' approach will be required to recognise bigger and potentially more provisions for onerous contracts. However, companies that have been applying the full cost approach shall remain unaffected by this amendment.

Figure 3: Costs of fulfilling a contract

(Source: Assessing if a contract is onerous, by KPMG IFRG Limited, 14 May 2020)

  Inclusions of all costs that relate directly to a contract provides more useful and transparent information to the users of the entity's financial statements and this approach is also consistent with other requirements in Ind AS 37 and other Ind AS Standards.

- **Impact of COVID-19:** With the disruption caused by COVID-19 on business operations, and the uncertainty of the economic environment, there may be an increased number of onerous contracts. For example, costs to deliver on existing revenue contracts may rise (e.g. if the company needs to find an alternative supplier or incur extra cleaning costs on the project); benefits expected from existing purchasing contracts may fall (e.g. lower demand may impact customer pricing, making it difficult to resell committed purchases at a profit). Companies should revisit their existing contracts to determine whether the amended provisions would make these contracts onerous, considering the current economic environment. Companies should also consider whether the contracts contain any force majeure provisions that may allow termination with no penalty or with a reduced penalty[6].

Annual Improvements to Ind AS (2021)

Fees in the '10 per cent' test for derecognition of financial liabilities – This clarification will enable entities to determine the fees to be considered while performing the 10 per cent test while assessing derecognition of a financial liability. For further clarification, entities may refer to paragraph B5.4.2 of Ind AS 109, which enumerates the fees that are an integral part of the effective interest rate of a financial instrument.

[6] As per Ind AS 37, the least net cost of exiting from a contract would be the lower of the cost of fulfilling it and any compensation or penalty arising from failure to fulfill it. Therefore, contracts that can be terminated without incurring any penalty may not be onerous.

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The bottom line

The amendments issued to Ind AS provide clarification in various aspects of accounting. Entities should take note of the disclosures required to be provided in the financial statements for the year ended 31 March 2022.

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

Issue no. 69 – April 2022

The topics covered in this issue are:

- Gross vs Net accounting – Cloud computing arrangements
- Accounting for corporate guarantees in standalone financial statements of a parent company
- ISSB introduces the proposals on global baselines standards for sustainability disclosures
- Regulatory updates

SEBI issues clarification on certain provisions pertaining to RPTs

29 April 2022

Based on representations received from listed entities and industry bodies, the Securities and Exchange Board of India (SEBI), on 30 March 2022 and 8 April 2022 issued certain clarifications and guidance in relation to the amendments to the provisions pertaining to Related Party Transactions (RPTs).

These circulars are applicable from 1 April 2022.

In this issue of first notes, we aim to provide an overview of the clarifications issued by SEBI.

Voices on Reporting

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

On 7 April 2022, KPMG in India held a VOR webinar to discuss key financial reporting and regulatory matters that are expected to be relevant for shareholders. The webinar covered key updates for the quarter ended 31 March 2022 and certain important updates relevant for financial year 2022-23.

To access the presentation and recording, please click here.

VOR annual update publication for the year ended 31 March 2022

Annual updates publication (for the year ended 31 March 2022) provides a summary of key updates from the Securities and Exchange Board of India (SEBI), the Ministry of Corporate Affairs (MCA), the Institute of Chartered Accountants of India (ICAI) and the Reserve Bank of India (RBI).To access the publication, please click here.

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