IFRS Notes

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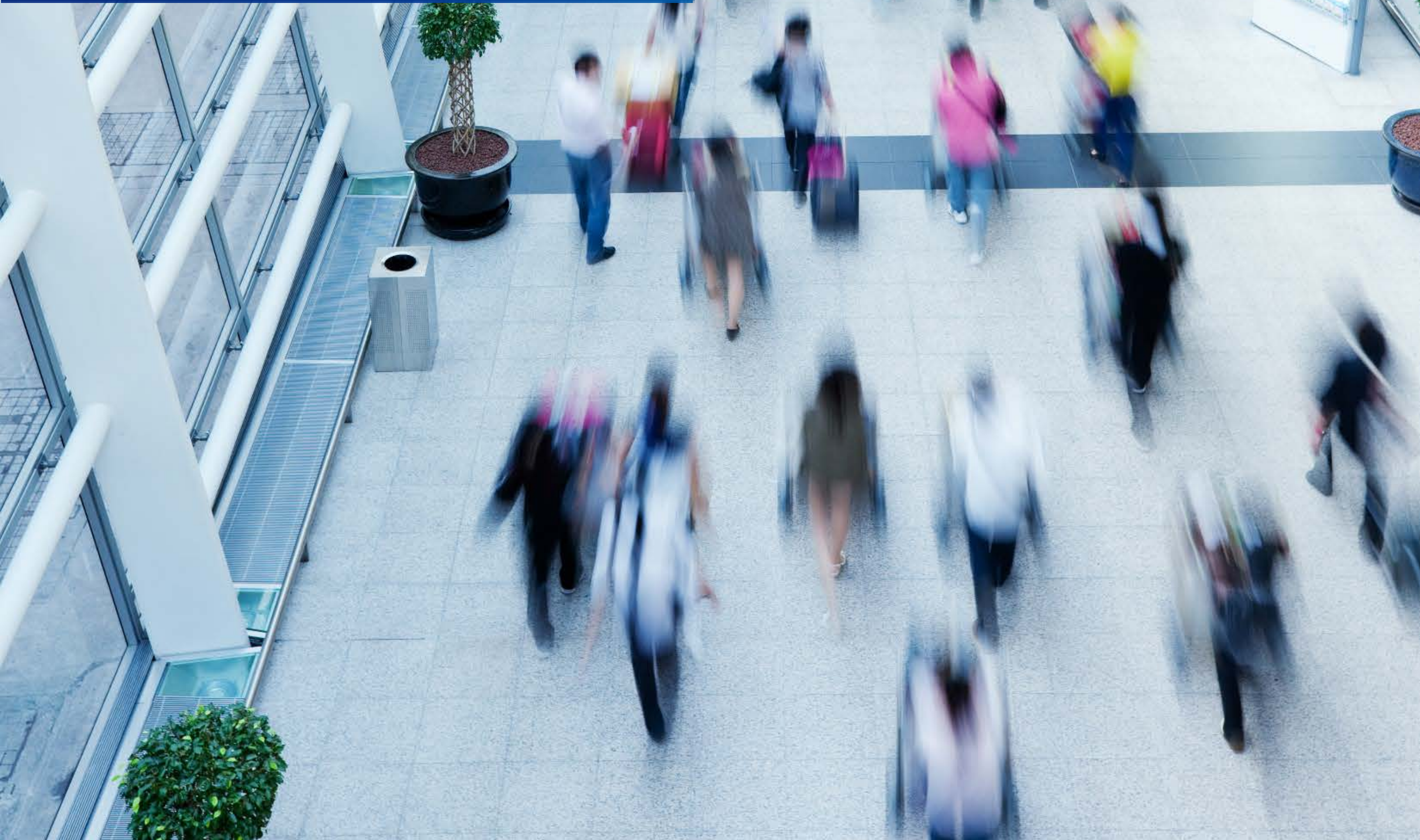
IFRS Convergence: ICAI issues exposure drafts on financial instruments and revenue recognition

KPMG

cutting through complexity



Recently, the Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI) has issued exposure drafts on Ind AS 109, *Financial Instruments* (ED on financial instruments) and Ind AS 115, *Revenue from Contracts with Customers* (ED on revenue).

These exposure drafts are in line with the requirements of the corresponding International Financial Reporting Standards (IFRS) (IFRS 9, *Financial Instruments* and IFRS 15, *Revenue from Contracts with Customers)*, the International Accounting Standards Board (IASB) has recently issued.

In this issue of IFRS Notes, we have provided an overview of these exposure drafts along with key impact areas.

It is important to note that India will be the first major economy within the G20 to fully adopt these new standards on revenue recognition and financial instruments, a year or two before these become effective internationally. Indian companies will therefore have to chart their own course as they implement these standards and would not have the benefit of learning from others experiences. Given the pervasive nature of these new standards, in addition to the financial reporting impacts, companies will also have to assess impact on other areas such as tax planning, compliance with loan covenants, incentive plans, etc. and the related changes to systems and processes including, contracting processes, IT systems, and internal controls. Early preparation will allow companies to develop an efficient implementation plan and engage with their key stakeholders.

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Key highlights of the ED on financial instruments

Background

ED on financial instruments is based on IFRS 9. On 24 July 2014, the IASB has issued the completed version of IFRS 9 which replaces IAS 39, *Financial Instruments: Recognition and Measurement*. This project was launched in 2008 in response to the financial crisis.

The IASB had divided the project to replace IAS 39 into three main phases, namely a) Phase I: classification and measurement of financial assets and financial liabilities b) Phase II: impairment methodology, and c) Phase III: hedge accounting. To implement each of these phases, the IASB had issued various versions of IFRS 9 in 2009, 2010, and 2013. The final version i.e. IFRS 9 (2014) consolidates the previous three versions of IFRS 9 to replace IAS 39 in entirety.

Scope

The ED on financial instruments largely proposes to carry forward the scope of Ind AS 39, *Financial Instruments: Recognition and Measurement* (Ind AS 39), i.e. ED on financial instruments would apply to all entities and to all types of financial instruments with certain specified exceptions from the scope. Examples of the instruments that are in the scope of the ED are as following:

- Lease receivables recognised by a lessor are subject to the derecognition and impairment requirements of the ED on financial instruments
- Finance lease payables recognised by a lessee are subject to the derecognition requirements of the ED on financial instruments
- Derivatives that are embedded in leases are subject to the embedded derivatives requirements of the ED on financial instruments
- In some cases, Ind AS 110, *Consolidated Financial Statements*, Ind AS 27, *Separate Financial Statements* or Ind AS 28, *Investments in Associates* require or permit an entity to account for an interest in a subsidiary, associate or joint venture in accordance with some or all of the requirements of the ED on financial instruments
- Entities would also apply this ED on financial instruments to derivatives on an interest in a subsidiary, associate or joint venture unless the derivative meets the definition of an equity instrument in Ind AS 32
- ED on financial instruments applies to an insurance contract that is a financial guarantee entered into, or retained, on transferring to another party financial assets or financial liabilities in the scope of the ED on financial instruments, and the issued financial guarantee contracts would not be accounted for under Ind AS 104, *Insurance Contracts*. Financial guarantee contracts held are not in the scope of the ED on financial instruments.

In addition, certain other instruments have been proposed to be included in the scope of the ED on financial instruments:

- certain contracts that are subject to own-use exemption
- items in the scope of its impairment requirements:
  - loan commitments issued that are not measured at fair value through profit or loss
  - contract assets in the scope of ED on revenue.

Recognition and derecognition

ED on financial instruments proposes that financial assets and financial liabilities including derivative instruments would be recognised in the balance sheet when the entity becomes party to a contract that is a financial instrument. However, regular-way purchases and sales of financial assets would be recognised either at trade date or at settlement date.

Financial instruments include a broad range of financial assets and financial liabilities. They include both primary financial instruments (e.g. cash, receivables, debt, shares in another entity) and derivative financial instruments (e.g. options, forwards, futures, interest rate swaps, currency swaps).

The ED on financial instruments provides following examples of applying the recognition principle:

- Unconditional receivables and payables are recognised as assets or liabilities when the entity becomes a party to the contract and, as a consequence, has a legal right to receive or a legal obligation to pay cash.
- Assets to be acquired and liabilities to be incurred as a result of a firm commitment to purchase or sell goods or services are generally not recognised until at least one of the parties has performed under the agreement.
- A forward contract that is within the scope of this ED would be recognised as an asset or a liability on the commitment date, instead of on the date on which settlement takes place. When an entity becomes a party to a forward contract, the fair values of the right and obligation are often equal, so that the net fair value of the forward is zero. If the net fair value of the right and obligation is not zero, the contract is recognised as an asset or liability.
- Option contracts that are within the scope of this would be recognised as assets or liabilities when the holder or writer becomes a party to the contract.
- Planned future transactions, no matter how likely, are not assets and liabilities because the entity has not become a party to a contract.

However, the ED on financial instruments proposes to include new guidance (in comparison to Ind AS 39) on write-offs of financial assets clarifying that a write-off constitutes a derecognition event for a financial asset or a portion thereof, and explaining when an asset (or a portion) should be written off. In addition, the ED on financial instruments proposes that a modification of the terms of a financial asset may lead to its derecognition.

A financial asset would be derecognised only when the contractual rights to the cash flows from the financial asset expire or when the financial asset would be transferred and the transfer meets certain specified conditions.

An entity would not derecognise a transferred financial asset if it retains substantially all of the risks and rewards of ownership.

An entity would continue to recognise a transferred financial asset to the extent of its continuing involvement if it has neither retained nor transferred substantially all of the risks and rewards of ownership, and it has retained control of the financial asset.

Classification of financial assets

The ED on financial instruments proposes three principal measurement categories for financial assets:

- amortised cost
- fair value through other comprehensive income (FVOCI)
- fair value through profit and loss account (FVTPL).

The ED on financial instruments proposes to remove the existing categories (under Ind AS 39) of held-to-maturity, loans and receivables, and available-for-sale.

A financial asset would be classified as being subsequently measured at amortised cost if the asset is held within a business model whose objective is to collect contractual cash flows, and the contractual terms of the financial asset give rise to cash flows that are solely payments of principal and interest (the 'SPPI criterion').

A financial asset would be classified as being subsequently measured at FVOCI if it meets the SPPI criterion and is held in a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets.

All other financial assets are proposed to be classified as being subsequently measured at FVTPL. In addition, an entity may, at initial recognition, irrevocably designate a financial asset as at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Classification of financial liabilities

The ED on financial instruments proposes that financial liabilities would be classified into two categories either at fair value through profit or loss (FVTPL) or at amortised cost.

It is proposed that the gain or loss on a financial liability designated as FVTPL, attributable to changes in credit risk, would be presented in other comprehensive income (OCI); the remaining amount of change in fair value is presented in the statement of profit and loss.

Embedded derivatives

An embedded derivative is a component of a hybrid contract that affects the cash flows of the hybrid contract in a manner similar to a stand-alone derivative contract.

The ED on financial instruments proposes that when a hybrid contract contains a host that is a financial asset in the scope of this ED, then the entire hybrid contract, including all embedded features, would be assessed for classification under the ED on financial instruments i.e. the embedded derivative would not be separated. Instead, the whole hybrid instrument would be assessed for classification based on the criteria relating to cash flow characteristics and business model discussed earlier.

When a hybrid contract contains a host that is a financial asset outside the scope of this ED on financial instruments, e.g. a lease receivable or an insurance contract, then an entity would assess whether the embedded feature require separation.

Measurement at initial recognition

The ED on financial instruments proposes that financial assets and financial liabilities would be measured at fair value plus, for financial instruments not at FVTPL, eligible transaction costs.

Subsequent measurement - financial assets

For assets classified as subsequently measured at amortised cost, it is proposed that interest revenue, expected credit losses and foreign exchange gains or losses would be recognised in the statement of profit and loss. On derecognition, any gain or loss would be recognised in the statement of profit and loss.

For assets classified as subsequently measured at FVOCI, interest revenue, expected credit losses, and foreign exchange gains or losses would be recognised in the statement of profit and loss. Other gains and losses on remeasurement to fair value would be recognised in OCI. On derecognition, the cumulative gain or loss previously recognised in OCI would be reclassified from equity to the statement of profit and loss.

For assets classified as subsequently measured at FVTPL, all gains and losses would be recognised in the statement of profit and loss.

For equity investments for which subsequent changes in fair value are presented in OCI, the amounts recognised in OCI would never be reclassified to the statement of profit and loss. However, dividend income on these investments would generally be recognised in the statement of profit and loss.

Subsequent measurement - financial liabilities

The ED on financial instruments proposes that financial liabilities would be subsequently measured at amortised cost, at FVTPL or under specific measurement guidance carried forward from Ind AS 39.

The ED on financial instruments also proposes that the portion of the gain or loss on a financial liability designated as at FVTPL that is attributable to changes in its credit risk would generally be presented in OCI, with the remaining amount of the change in fair value presented in the statement of profit and loss.

Impairment

The ED on financial instruments proposes to replace the 'incurred loss' model in Ind AS 39 with an 'expected credit loss' model. The new model would apply to financial assets that would not be measured at FVTPL, including loans, lease and trade receivables, debt securities, contract assets under ED on revenue and specified financial guarantees and loan commitments issued. It would not apply to equity investments.

The model proposes to use a dual measurement approach, under which the loss allowance would be measured as either:

- 12 month expected credit losses, or
- lifetime expected credit losses.

The measurement basis generally would depend on whether there has been a significant increase in credit risk since initial recognition.

A simplified approach would be available for trade receivables, contract assets and lease receivables, allowing or requiring the recognition of lifetime expected credit losses at all times. Special rules would apply to assets that are credit-impaired at initial recognition.

Hedge accounting

The ED on financial instruments proposes more principles-based standard that is expected to align hedge accounting more closely with risk management. Hedge accounting allows an entity to measure assets, liabilities and firm commitments selectively on a basis different from that otherwise stipulated in the ED on financial instruments, or to defer the recognition in profit or loss of gains or losses on derivatives. Hedge accounting is voluntary. The ED on financial instruments proposes to permit hedge accounting only when strict requirements related to documentation and high effectiveness (no arbitrary bright lines) are met. The types of hedge accounting relationships proposed to be covered under the ED on financial instruments would be fair value, cash flow and foreign operation net investment.

Qualifying hedged items can be recognised assets or liabilities, unrecognised firm commitments, highly probable forecast transactions, net investments in foreign operations, risk components of non-financial items and non-contractually specified inflation, net positions and layer components of items, aggregated exposures (a combination of a non-derivative exposure and a derivative) and equity investments at fair value through OCI.

Qualifying hedging instruments would generally be derivative instruments entered into with an external party. However, for hedges of foreign exchange risk only, non-derivative financial instruments may qualify as hedging instruments. The ED on financial instruments also proposes that cash instruments may be hedging instruments in additional circumstances.

Qualifying hedged risk should be one that could affect profit or loss.

In its discussion of these general hedge accounting requirements, the IASB did not address specific accounting for open portfolios or macro-hedging. Instead, the IASB is discussing proposals for those items as part of its current active agenda and in April 2014 published a Discussion Paper on Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach to Macro-Hedging. Consequently, the ED on financial instruments also proposes an exception for a fair value hedge of an interest rate exposure of a portfolio of financial assets or financial liabilities. The ED on financial instruments also provides entities with an accounting policy choice between applying the hedge accounting requirements of the ED or continuing to apply the existing hedge accounting requirements in the Ind AS 39 for all hedge accounting.

Our view

The ED on financial instruments is proposed to be a comprehensive standard on accounting, presentation, disclosure of financial instruments and hedge accounting. Currently, under Indian GAAP there are various pieces of literature which provide guidance i.e. Accounting standard (AS)13, *Accounting for Investments*, AS 11, *The Effects of Changes in Foreign Exchange Rates,* and announcements of the ICAI in March 2008 relating to application of AS 1, *Disclosure of Accounting Policies*.

The ED on financial instruments is expected to have significant impact on the way financial assets would be classified and measured in India. The implementation of a business model approach and the SPPI criterion is expected to require judgement to ensure that financial assets would be classified into the appropriate category.

Estimating impairment is another area that would be challenging for banks, insurers and other financial services entities, as there would be extensive new requirements for data and calculations.

Hedge accounting requirements in the ED on financial instruments are likely to be supported by many entities. The requirements provide more principles-based approach that aligns hedge accounting more closely with risk management. However, some entities in certain industries like banking and insurance may find that the ED on financial instruments does not significantly change the 'status quo', and may like to wait for the IASB's macro-hedging project to be concluded.

Impact

The ED on financial instruments is expected to have a significant impact on how banks account for credit losses on their loan portfolios. Provisions for bad debts are likely to be bigger and are likely to be volatile, and adopting the new rules could require a lot of time, effort and money.

Insurers could also be significantly impacted by ED on financial instruments if the regulator in India adopts the final standard on both financial instruments and insurance contracts.

Other corporates should not automatically assume that the impact of classification, measurement and impairment requirements to be small, as this depends on the exposures they have and how they manage them.

All sectors are expected to be affected by extensive new disclosure requirements.

The ASB has asked for inputs on two specific questions:

- FVOCI election for equity instruments: For entities that would select this option, the financial instruments prohibit recycle of gain or loss on remeasurement (accumulated in the OCI) to the statement of profit and loss. Additionally, impairment requirements of the ED on financial instruments do not apply to such equity instruments.

  The ASB has asked whether in India gain or loss on such equity instrument should be required to be reclassified in the statement of profit and loss at the time of derecognition. Our preliminary analysis is that recycling of gains and losses to the statement of profit and loss would create something similar to the available-for-sale category in Ind AS 39 and would not obviate the requirement to assess the equity instrument for impairment, which had created application problems under Ind AS 39.

  In its basis for conclusion of IFRS 9, the IASB has mentioned that the requirement to recycle gains and losses accumulated on the OCI to the statement of profit and loss would not significantly improve or reduce the complexity of the financial reporting for financial assets. Accordingly, the IASB decided to prohibit recycling of gains and losses into the statement of profit and loss when an equity instrument is derecognised.

- Accounting policy choice to apply hedge accounting as per Ind AS 39 or ED on financial instruments: The IASB is deliberating on macro-hedge accounting and has issued a discussion paper, DP 2014/01 Accounting for Dynamic Risk Management: A Portfolio Revaluation Approach to Macro-Hedging, in April 2014. Pending the finalisation of the macro-hedge accounting project, the hedge accounting model in the ED on financial instruments carries forward guidance from Ind AS 39 on portfolio fair value hedges of interest rate risk and allows an entity an accounting policy choice to apply all of the hedging requirement in Ind AS 39 rather than applying the new general hedge accounting model in the ED on financial instruments. Our preliminary thoughts are that the ASB should align with IFRS and continue with the option to apply Ind AS 39 guidance.

Key highlights of the ED on revenue

ED on revenue is based on IFRS 15, *Revenue from Contracts from Customers*. On 28 May 2014, the FASB and the IASB issued a new accounting standard ASC Topic 606/IFRS 15, *Revenue from Contracts with Customers*. The new standard replaces IAS 11, *Construction Contracts*, IAS 18, *Revenue*, IFRIC 13, *Customer Loyalty Programmes*, IFRIC 15, *Agreements for the Construction of Real Estate*, IFRIC 18, *Transfers of Assets from Customers* and SIC-31, *Revenue- Barter Transactions Involving Advertising Services*.

The standard took over five years in development which involved the issue of a joint discussion paper and two joint exposure drafts, consideration of public comment letters and feedback from other outreach efforts, and holding a number of joint and separate meetings to re-deliberate key aspects of the standard.

The objectives of the converged standard is as following:

- To simplify preparation of financial statements by reducing the number of requirements by having one revenue framework
- To remove inconsistencies and weaknesses in the existing requirements
- To provide a more robust framework for addressing revenue issues
- To provide more useful information through improved disclosure requirements.

Overall approach

The ED on revenue proposes to provide a framework that replaces Ind AS 11, *Construction contracts*, and Ind AS 18, *Revenue*. Entities would be required to apply a five step model to determine when to recognise revenue, and at what amount. The ED on revenue provides application guidance on numerous related topics, including warranties and licenses. It also provides guidance on when to capitalise the costs of obtaining a contract and some costs of fulfilling a contract (specifically those that are not addressed in other relevant authoritative guidance e.g. inventory).

The model proposed in the ED on revenue features a contract-based five-step analysis of transactions, focussing on the transfer of control, to determine whether, how much and when revenue should be recognised.

Applying the five step model

Step 1 - Identify the contract with a customer

An entity would account for a contract in accordance with the model when the contract is legally enforceable and all of the following criteria are met:

- the contract is approved and the parties are committed to their obligations
- rights to goods or services and payment terms can be identified
- the contract has commercial substance
- collection of the consideration is considered probable.

Step 2 - Identify the performance obligations in the contract

A performance obligation is a promise to deliver a good or service that is distinct, in other words:

- the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer
- the entity's promise to transfer the good or service to customer is separately identifiable from the other promises in the contract.

An entity would account for a series of distinct goods and services as a single performance obligation if they are substantially the same and have the same pattern of transfer.

Step 3 - Determine the transaction price

The 'transaction price' is the amount of consideration to which an entity expects to be entitled in exchange for transferring the goods or services to the customer.

In determining the transaction price, an entity would consider the effects of variable consideration (including the constraint), whether there is a significant financing component in the arrangement, consideration payable to the customer and non-cash consideration.

Sales and usage-based royalties arising from licenses of intellectual property are proposed to be excluded from the transaction price and would generally be recognised as the subsequent sale or usage occurs.

Step 4 - Allocate the transaction price to the performance obligations in the contract

The transaction price is proposed to be allocated to the performance obligations in a contract on the basis of relative stand-alone selling prices. The best evidence of the stand-alone selling price is an observable price from stand-alone sales of that good or service to similarly situated customers. However, if the stand-alone selling price is not directly observable, entities may estimate the amounts using a suitable method, e.g.:

- *Adjusted market assessment approach* - evaluating the market in which they sell goods or services and estimating the price customers would be willing to pay,
- *Expected cost plus a margin approach* - forecasting expected costs plus an appropriate margin, or
- *Residual approach* - in limited circumstances, subtracting the sum of observable stand-alone selling prices of other goods or services in the contract from the total transaction price.

Discounts and variable consideration may be allocated to one or more specific performance obligations in certain circumstances.

Step 5 - Recognise revenue

The ED on revenue provides two approaches for recognising revenue, reflecting the principle that revenue recognised when (or as) an entity transfers goods or services to customers.

Except for distinct licenses of intellectual property, which are subject to specific guidance in the ED on revenue, revenue is proposed to be recognised over time if one of the following criteria is met:

- The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs.
- The entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced.
- The entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.

If a performance obligation is not satisfied over time, then the entity would recognise revenue at the point in time at which it transfers control of the goods or services to the customer.

Contract costs

Costs to obtain a contract

An entity would capitalise incremental costs incurred only as a result of obtaining a contract, e.g. sales commissions if the entity expects to recover these costs. However, a practical expedient allows an entity to expense such costs as incurred if the amortisation period of the asset is one year or less.

Costs to fulfil a contract

If the costs incurred in fulfilling a contract are not in the scope of other guidance, e.g. inventory, intangibles or property, plant and equipment, then an entity would recognise an asset only if the fulfillment costs meet the following criteria:

- they relate directly to an existing contract or specific anticipated contract
- they generate or enhance resources of the entity that will be used to satisfy the performance
- obligations in the future
- they are expected to be recovered.

Amortisation and impairment of capitalised costs

Capitalised costs would be amortised on a systematic basis, consistent with the pattern of transfer of the good or service to which the asset relates, and would be subject to impairment testing. The amortisation period would include expected contract renewal periods.

Contract modifications

Identifying a contract modification

A contract modification is any change in the scope or price of a contract (or both). It exists when the parties to a contract approve a modification that creates new or changes existing, enforceable rights and obligations of the parties to the contract.

Consistent with the identification of a contract, the ED on revenue proposes that a contract modification would have to be legally enforceable. A modification could be approved in writing, by oral agreement, or as implied by customary business practices.

Accounting for a contract modification

To faithfully depict the rights and obligations arising from a modified contract, the ED on revenue proposes that an entity would account for modifications either on a prospective basis (when the additional goods or services are distinct) or on a cumulative catch-up basis (when the additional goods or services are not distinct).

A contract modification would be treated as a separate contract (prospective treatment) if the modification results in:

- a promise to deliver additional goods or services that are distinct, and
- an increase to the price of the contract by an amount of consideration that reflects the entity’s standalone selling price of those goods or services adjusted to reflect the circumstances of the contract.

If these criteria are not met, the entity's accounting for the modification would be based on whether the remaining goods or services under the modified contract are distinct from those goods or services transferred to the customer before the modification.

Our view

The ASB has issued exposure draft on one of the most important financial reporting metrics i.e. revenue, which will apply to almost all companies reporting under the Ind AS. The proposed five step model represents a paradigm shift for several sectors from the present revenue recognition principles in India.

Impact

The proposed requirements will likely affect different companies in different ways. Companies that sell products and services in a bundle, or those engaged in major projects e.g. in the telecom, software, engineering, construction and real estate industries could see significant changes to the timing of revenue recognition. For others, it may be more a case of 'business as usual'.

However, all companies would need to assess the extent of the impact, so that they can address the wider business implications. In particular, the proposed disclosure requirements are extensive and might require changes to systems and processes to collect the necessary data even if there is no change to the headline numbers in the financial statements.

Compared with the current situation, revenue recognition may be accelerated or deferred for transactions with multiple components, variable consideration or licenses. Key financial measures and ratios may be impacted, affecting analyst expectations, earn-outs, compensation arrangements and contractual covenants. Entities will need processes to capture new information at its source e.g. executive management, sales operations, marketing and business development, and document it appropriately, particularly as it relates to estimates and judgements.

Applying the proposed model will require a detailed review of contract terms and evaluation and the nature of performance obligation. Where entity uses the stage of completion method or otherwise enters into long-term contracts, such entities would need to evaluate whether to recognise revenue on contract completion or as the contract is fulfilled. Where the entity recognises revenue over time, the manner in which progress towards completion is measured may change.

Few of the fundamental differences from AS 9, *Revenue Recognition,* are as follows:

- AS 9 follows the risks and rewards approach while the ED on revenue proposes a control based model. Risk and rewards is retained as an indicator of control transfer.
- AS 9 does not provide the guidance on the determination of transaction price while the ED on revenue proposes that transaction price is the consideration an entity is entitled to i.e., the amount that is highly probable.
- AS 9 provides limited guidance on identifying performance obligations in a contract while the ED on revenue proposes specific guidance for separating goods and services in a contract, recognising revenue over time, licenses and variable consideration.

The ASB has asked three specific questions, they are as follows:

- The recoverability criterion has been shifted from measurement of revenue to identification of contract under the five step model: Our preliminary thoughts are the criterion designed in the ED on revenue would prevent entities from applying the revenue model to problematic contracts and recognising revenue and a large impairment loss at the same time. For most sectors, the shift of criterion is unlikely to have a significant effect on the current practice. Entities should review the terms and conditions of the revenue contracts in detail to ensure that these contracts qualify under the contract identification criteria as proposed by the ED on revenue.
- Accounting of advance received when a contract does not meet the criterion for identification of a contract under the ED on revenue: Our preliminary thoughts are the approach explained in the ED on revenue is being followed in practice by companies in India. The ED on revenue provides specific guidance on recognising performance obligation i.e. a performance obligation is the unit of account for revenue recognition. Unless the performance obligation is complete and the consideration received is non-refundable it would be incorrect to recognise revenue.
- Previous carve-out of IFRIC 15, *Agreements for the Construction of Real Estate*: The Ministry of Corporate Affairs (MCA) had published Ind AS in February 2011 and those Ind AS included a carve- out of IFRIC 15. The ED on revenue includes guidance for all the sectors. Under the ED on revenue, progressive revenue recognition will only be permitted where the enforceable contractual rights and obligations satisfy certain criteria. There is no automatic right to recognise revenue on a progressive basis for construction type contracts. Therefore, the contracts need to be assessed carefully to ensure that control is transferred to the buyer.

Next steps

We expect the National Advisory Committee on Accounting Standards (NACAS) and the MCA to review these exposure drafts and notify the final Ind AS in the coming months. Similar to the transition time provided on IFRS 9, *Financial Instruments* and IFRS 15, *Revenue from Contracts with Customers* by the international standard setters, NACAS should also issue these standards at the earliest, providing adequate transition time to preparers given the pervasive and sensitive implications of these standards. Considering India would be one of the first countries to adopt the new standard of revenue and financial instruments, we would not have the ability to learn from others' experience on adoption of these standards, rather we will be the trend setters.

Find out more

For details of these two exposure drafts, click ED on revenue and ED on financial instruments.

Additionally, refer to following for detailed overview of:

- IFRS 9, *Financial Instruments*

  Accounting and Auditing Update for August 2014

  Voices on Reporting call for August 2014

- IFRS 15, *Revenue from Contracts with Customers*

  Accounting and Auditing Update for July 2014

  Voices on Reporting call for June 2014

- KPMG's publication First Impressions: Revenue from Contracts with Customers June 2014
- KPMG's publication Issues In-Depth: Revenue from Contracts with Customers September 2014
- KPMG's Publication First Impressions: IFRS 9 Financial Instruments September 2014

List of recent exposure drafts issued by the ASB

- Exposure draft on the Ind AS 101, *First-Time Adoption of Indian Accounting Standards*
- Exposure draft of Amendments to Ind ASs: *Consideration of Carve outs/ins*
- Exposure draft of the Further Amendments to Ind ASs: *Consideration of Carve outs/ins*
- Exposure draft of further amendments to Ind AS 16, *Agriculture: Bearer Plants*
- Exposure draft of Ind AS 41, *Agriculture*
- Exposure draft of Ind AS 109, *Financial Instruments*
- Exposure draft of Ind AS 115, *Revenue from Contracts with Customers*

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Voices on Reporting

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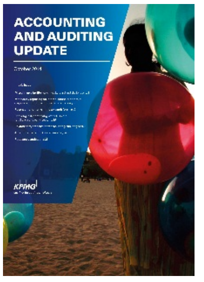
The Central Board of Direct Taxes (CBDT) has amended Form No. 3CA, Form No. 3CB and Form No. 3CD of the Income-tax Rules, 1962 (the Rules). There are a number of significant amendments to the Form No. 3CD. Due to the amendments made in the Form No. 3CD, the reporting responsibilities of the assessee and the auditor have increased considerably.

The revised clause 49 of the Equity Listing Agreement was issued by the Securities and Exchange Board of India (SEBI) in April 2014 to be applicable to all listed companies from 1 October 2014. SEBI received various representations from industry associations, companies and other market participants seeking clarifications and interpretation relating to certain provisions of the Equity Listing Agreement. The SEBI also sought the status of preparedness of top 500 listed companies by market capitalisation for ensuring timely compliance with the revised clause 49. To address the concerns and to help the listed companies to ensure compliance with the provisions of the revised clause 49, the Securities and Exchange Board of India (SEBI) vide circular dated 15 September 2014 has amended some of the requirements of the revised clause 49.

In our call, we discussed these amendments and developments.

Missing an issue of the Accounting and Auditing Update or First Notes



The October 2014 edition of the Accounting and Auditing Update provides insights into the microfinance sector in India and its distinct story of turnaround, continuing challenges and opportunities. We cover an article on the Companies Act, 2013 – reporting on internal financial controls and highlight some of the critical aspects of these requirements. This month we have covered some additional perspectives on related party transactions. This issue also covers recent changes to the tax audit report and key accounting and reporting issues associated with the foreign direct investment in the retail cash and carry sector.

The MCA rationalises norms relating to consolidated financial statements and internal financial controls system

The Companies Act, 2013 was largely operationalised from 1 April 2014. The Ministry of Corporate Affairs (MCA) vide notifications dated 14 October 2014 has amended/clarified provisions relating to:

- the preparation of consolidated financial statements (CFS) by an intermediate wholly-owned subsidiary – amended to provide an exemption
- the preparation of CFS by companies having just an associate or a joint venture – amended to grant a transition period
- reporting on the internal financial control systems by auditors, mandatory for financial years commencing on or after 1 April 2015 – amended to grant a transition period
- the Schedule III-related disclosures made in stand-alone financial statements which are not to be repeated in CFS.

Our First Notes provides an overview of these amendments.

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