IFRS NOTES

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Amendments to Ind AS: Carve-outs

KPMG
cutting through complexity

It is quite evident from the proposed changes in the exposure drafts released by ICAI that the new version of Ind AS standards that are being finalised, are expected to be much closer to IFRS as compared to the earlier standards that the MCA had published. By keeping the deviations and carve-outs to the bare minimum, we can expect Indian companies and their stakeholders to truly benefit from the convergence with IFRS. Further, ICAI's due process of inviting comments on the carve-outs is a welcome step. This consultative approach will help ensure acceptability of carve-outs by preparers.

These initial steps clearly indicate that we are headed in the right direction.

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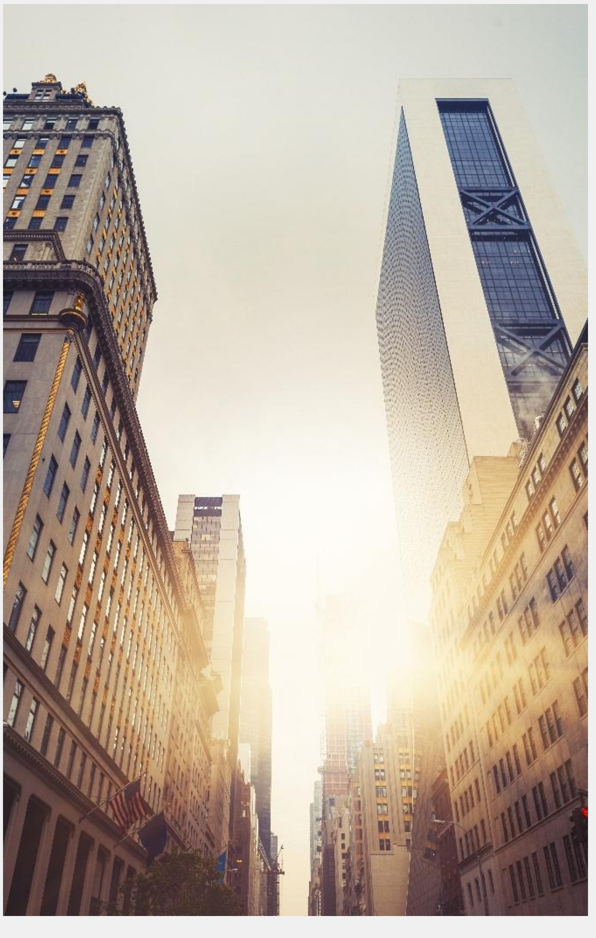

The finance minister in his budget speech recognised the need to converge the current accounting standards under Indian GAAP with IFRS. He proposed to make these IFRS converged Indian Accounting Standards (Ind AS) mandatory for Indian companies from the financial year 2016-17. He also mentioned that the companies could opt to adopt Ind AS voluntarily from the financial year 2015-16.

The date of implementation of Ind AS for banks and insurance companies is likely to be notified separately by the respective regulators. Similarly, the finance minister has stated that standards for computation of tax will be notified separately.

With the finance minister having set the ball in motion, various stakeholders including regulators and standard setters have been working towards ensuring their readiness to facilitate convergence with IFRS by Indian companies.

The Ministry of Corporate Affairs (MCA) had published 35 Ind AS on 25 February 2011. The MCA did not finalise and declare the exact implementation date of the Ind AS. The Ind AS published by the MCA had certain important aspects where Ind AS is not in conformity with IFRS (commonly, known as carve-outs).

Recently, the Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI) has started revisiting the earlier carve-outs and certain other issues for further possible carve-outs/ins in the Ind AS. On 17 September 2014 and 24 September 2014, the ICAI has issued in two tranches, exposure drafts on the 'Amendments to Indian Accounting Standards – Consideration of carve-outs/ins'.

In this issue of IFRS Notes, we have summarised the proposed amendments into three categories:

- Areas different from IFRS (carve-outs from IFRS)
- areas where Ind AS is proposed to be aligned with IFRS (i.e. earlier there was a carve-out)
- areas where Ind AS proposes to provide additional guidance (carve-ins).

Last date to provide comments to these exposure drafts is 15 October 2014.

The table below provides a summary of the proposed amendments:

Ind AS standard	Proposed amendments released by the ICAI
Areas different from IFRS	
Ind AS 1, *Presentation of Financial Statements*	The proposed amendment allows entities to continue classifying loans as non-current in case of a minor procedural breach of covenants based on past experience.
Ind AS 17, *Leases*	The proposed amendment allows entities to avoid using straight-lining of rentals in case the escalation reflects expected inflationary cost increases.
Ind AS 27, *Separate Financial Statements*	The proposed amendment removes the option of using equity method by entities for accounting of their investments in separate financial statements under IFRS.
Areas where Ind AS is proposed to be aligned with IFRS	
Ind AS 24, *Related Party Disclosures*	The proposed amendment is expected to align the definition of 'close members of the family of a person' with the definition under IFRS rather than with the Companies Act as was envisaged previously.
Ind AS 28, *Investment in Associates*	Three amendments have been proposed: • To remove carve-out in the Ind AS (published by the MCA in February 2011) where in entities could avoid aligning the accounting policy or reporting date of associates and joint ventures, if it was considered impracticable • To provide an exemption to the intermediate parent entities from applying equity method, if certain criteria is met • To allow venture capital funds, mutual funds, unit trust and similar entities to measure their interest in associates and joint ventures at fair value through profit or loss.
Ind AS 21, *The Effects of Changes in Foreign Exchange Rates*	The proposed amendment removes the earlier carve-out in Ind AS 21 (published by the MCA in February 2011) to defer exchange rate fluctuations on certain long-term monetary assets and liabilities.
Ind AS 110, *Consolidated Financial Statements*	The proposed amendment provides an exemption to the intermediate parent entities from preparing consolidated financial statements if certain criteria are met.
Areas where Ind AS proposes to provide additional guidance	
Ind AS 102, *Share-based Payment*	The proposed amendment provides additional guidance on accounting for employee share-based payment administered by an entity through creation of a trust.
Ind AS 103, *Business Combinations*	The proposed amendment provides guidance on accounting for business combination under common control.

Areas different from IFRS

Ind AS 1, *Presentation of Financial Statements*

Current and non-current classification of liabilities

According to IAS 1, *Presentation of Financial Statements*, a liability that is payable on demand because a loan condition has been breached is classified as current even if the lender has agreed, after the end of the reporting period but before the financial statements are authorised for issue, not to demand repayment as a result of the breach.

The proposed carve-out in Ind AS states that if there is a minor procedural breach of the nature that does not result in payment on demand based on the past experience of the entity, then it would not result in classifying the liability as current liability.

The ICAI has proposed this as a practical expedient for cases when there is a default in compliance with minor procedural loan covenants where lenders do not exercise their rights to recall the loan. This carve-out is based on the similar guidance provided in the Guidance Note on Schedule VI (now Schedule III under the Companies Act, 2013) issued by the ICAI. However, this exception should not be applied by analogy to events, conditions and transactions other than loan contracts that have a specified schedule of payment of interest and principal measured at amortised cost in accordance with Ind AS 109, *Financial Instruments*.

Our views

This proposed amendment carries forward the current practise under the Revised Schedule VI (now schedule III under the Companies Act, 2013), and is meant to alleviate issues around temporary reclassifications of long term loans for breaches of covenants that are not considered to be substantive, based on past experience. However, this issue could be addressed in the long term by having the loan agreements amended to reflect only substantive breaches, rather than amend the standard to deal with what may be a short-term problem. Also what constitutes minor procedural breach could be subjective leading to companies classifying loans with similar breaches differently.

Ind AS 17, *Leases*

Amortisation of lease payments

According to IAS 17, *Leases*, for an operating lease, a lessee recognises rent expense on a straight-line basis over the lease term, or on another systematic basis if it is more representative of the pattern of benefits to the lessee over time. The proposed carve-out provides exceptions to the principle of straight-lining rent expense and the exceptions allow a lessee to either

- recognise rent expense by using another systematic basis if it is more representative of the pattern of benefits to the lessee over time even if the payments are not on that basis, or
- not straight-line over the lease term where 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 carve-out would not be available.

Amortisation of lease income

According to IAS 17, for an operating lease, a lessor recognises lease income on a straight line basis over the lease term, unless another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished.

The proposed carve-out clarifies that the lease income from operating lease would exclude amounts for services such as insurance and maintenance. Further, the proposed carve-out provides exceptions to the principle of straight-lining lease income and the exceptions allow a lessor to either

- recognise lease income by using another systematic basis if it is more representative of the pattern of benefits from the leased asset is diminished, even if the receipt of payments is not on that basis, or
- not straight-line over the lease term where 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 the factors other than general inflation, then this carve-out is not available.

Our views

The proposed amendment attempts to reflect an economic reality in developing economies such as ours, where companies enter into long term leases, with periodic inflation driven escalations, by avoiding the hardship of front ending costs when lease rentals are straight-lined. It is important to note that currently, AS 19, *Leases* , requires lease rent and income to be recognised on a straight-line basis, in line with the requirements of IFRS.

Ind AS 27, *Separate Financial Statements*

Method of accounting of investments in separate financial statements

On 12 August 2014, the International Accounting Standards Board (IASB) amended IAS 27, *Separate Financial Statements*, which allows entities to use the equity method to account for investment in subsidiaries, joint ventures and associates in their separate financial statements. However, Ind AS 27 (published by the MCA in February 2011) does not allow use of equity method in the separate financial statements.

The proposal of the ICAI is that Ind AS would continue to not allow use of equity method in the separate financial statements as the equity method is not a measurement basis like cost or fair value. It is a manner of consolidation and therefore, may lead to inconsistent accounting conceptually.

Our views

The proposed amendment is aimed at removing an option, and enhance comparability.

Areas where Ind AS is proposed to be aligned with IFRS

Ind AS 24, *Related Party Disclosures*

Definition of close members of the family of a person

According to the Ind AS 24 (published by the MCA in February 2011), the definition of 'close members of the family of a person' is the persons specified within the meaning of 'relative' under the Companies Act, 1956 and that person's domestic partner, children of that person's domestic partner and dependants of that person's domestic partner.

The proposed amendment to Ind AS 24 modifies the definition of 'close members of the family of a person' to bring it in line with the definition in IAS 24, *Related Party Disclosures*, and reference to the Companies Act, 1956 has been removed.

According to the proposed amendment, the definition of 'close members of the family of a person' are those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity and include:

- that person's children and spouse or domestic partner
- children of that person's spouse or domestic partner
- dependants of that person or that person's spouse or domestic partner.

Our views

We support the proposed amendment in the definition of 'close members of the family of a person' to bring Ind AS in line with IFRS.

Ind AS 28, *Investments in Associates*

Scope of entities covered

According to Ind AS 28 (published by the MCA in February 2011), an entity (the investor) is required to account for investments in associates and joint ventures using the equity method except when the entity is a venture capital organisation. Venture capital organisations have an exemption to measure investments in associates and joint ventures at fair value through profit or loss (as per Ind AS 109).

The proposed amendment aligns the exemption to bring it in line with IFRS. Thus, allowing not only venture capital organisations but also mutual fund, unit trust and similar entities including investment-linked insurance funds to measure their investments in those associates and joint ventures at fair value through profit or loss (as per Ind AS 109).

Additionally, this proposed exemption would also be available when an entity has an investment in an associate, a portion of which is held indirectly through a venture capital organisation or a mutual fund, unit trust, and similar entities including investment-linked insurance funds.

Alignment of reporting date and policies

Ind AS 28 (published by the MCA in February 2011) provides a choice to an entity to follow different accounting policies while accounting for associates or joint ventures, where it is impracticable to follow uniform accounting policies of the investor. Similarly, if the financial year end date of an associate or a joint venture is different from that of an investor, Ind AS 28 (published by the MCA in February 2011) allowed the difference to be more than three months, if it was impracticable to use uniform accounting policies.

The proposed amendment removes these carve-outs for situations where it was considered impracticable to align the requirements of Ind AS with those in IFRS.

Our views

We support the proposed amendments to Ind AS 28 as they bring Ind AS in line with IFRS.

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

Removal of option to defer exchange rate fluctuations on certain long-term monetary assets and liabilities

Ind AS 21 (published by the MCA in February 2011) provided an option for unrealised exchange differences arising on certain long-term monetary assets and long-term monetary liabilities denominated in a foreign currency to be recognised directly in equity.

The proposed amendment removes the carve-out to align the requirements with that in IAS 21, *The Effects of Changes in Foreign Exchange Rates*, and also in view of IFRS 9, *Financial Instruments*. The ASB noted that as per IFRS 9, only those exposures can qualify for hedge accounting which have an impact on the statement of profit and loss. According to the Ind AS 21 (published by the MCA in February 2011), an entity would not recognise the gains and losses on foreign exchange fluctuations in profit or loss but in equity. Such an entity would not be able to use hedge accounting as per IFRS 9 and such an option would be inappropriate as the entity would be able to defer the gains/losses from foreign exchange risks.

Our views

The original amendment to AS 11, *The Effects of Changes in Foreign Exchange Rates*, was introduced at a time when India was facing significant volatility in its currency. However, since then, the currency markets have become more stable, and it may be appropriate to move back to an internationally accepted framework, rather than follow a practise that was practically expedient at that point in time. However, the proposed amendment to Ind AS could bring in an additional element of volatility in the profitability of those companies that adopted paragraph 46/46A under AS 11 if currency markets become volatile again.

Ind AS 110, *Consolidated Financial Statements*

Exemption from consolidated financial statements

IFRS 10, *Consolidated Financial Statements*, allows an intermediate parent an exemption from preparing consolidated financial statements if certain criteria are fulfilled. Ind AS (published by the MCA in February 2011) did not allow this exemption to intermediate parent entities and such entities were required to prepare consolidated financial statements.

The proposed amendment would align Ind AS to the requirements in IFRS by providing exemption to intermediate parent entities from preparing consolidated financial statements when certain criteria are fulfilled.

Similar to the proposed exemption from preparing consolidated financial statements under Ind AS 110, it has been proposed that Ind AS 28 would also provide an exemption to intermediate parent entities from applying equity method, if certain criteria are met.

Further, as a consequence to the above proposals, it is proposed to amend Ind AS 27 to allow an intermediate parent entity to prepare separate financial statements as its only financial statements (where such an entity is exempted from preparing consolidated financial statements as per Ind AS 110 or applying equity method as per Ind AS 28, if certain conditions are met).

Our views

The proposed exemption to the intermediate parent entity while it is aligned to IFRS, is not in line with the requirements in the Companies Act, 2013 and would require changes to the Companies Act, 2013.

Areas where Ind AS proposes to provide additional guidance

Ind AS 102, *Share-based Payment*

Accounting for employee share-based payment administered by an entity through creation of trust

Neither Ind AS 102 (published by the MCA in February 2011) nor IFRS 2, *Share-based Payment*, provide guidance on accounting of employee share-based payments administered by an entity through creation of a separate trust. The proposed amendment includes new guidance in Ind AS 102 regarding accounting of share-based payment plan administered through a trust.

According to the proposed amendment, an entity may administer a share-based payment plan through a trust constituted for this purpose. The trust may have different kinds of arrangements, for example, the following:

a. The entity allots shares to the trust as and when the stock options are exercised

b. The entity provides finance to the trust for subscription to the shares issued by the entity at the beginning of the plan

c. The entity provides finance to the trust to purchase shares from the market at the beginning of the plan.

The proposed amendment mentions that since the trust administers the plan on behalf of the entity, it is an extension of the entity as a branch/agent. The financial statements of the entity shall be prepared as if the entity itself is administering the plan.

Accordingly, the transactions of the trust should be included in the separate financial statements of the entity as if all the transactions of the trust are those of the entity. The transactions between the trust and third parties should be reflected in those financial statements as if these had been carried out by the entity itself. Loan, if any, given by the entity to the trust will not appear in the entity's separate financial statements. Any profit made by the trust on market operations shall be recognised in the equity of the entity.

The shares held by the trust shall be reflected in the separate financial statements of the entity. The face value of these shares shall be shown as a deduction from share capital and the excess paid over and above the face value shall be shown as deduction from securities premium with a detailed note explaining the facts. In the books of account, these shares will continue to remain recorded in a separate account and only for presentation purposes would be shown as deduction from share capital/securities premium.

Our views

The amendment adopts one of the internationally followed approaches and would help ensure there is uniformity in the accounting for such arrangements.

Ind AS 103, *Business Combinations*

Common control transactions

IFRS 3, *Business Combinations*, deals with the accounting for business combinations but scopes out business combinations of entities under common control. However, Ind AS 103 (published by the MCA in February 2011) provides guidance on accounting of the business combinations under common control and requires such combinations to be accounted for using pooling of interest method. The proposed amendment requires that any difference between consideration paid and share capital of the transferor should be transferred to a separate component of equity called 'common control transaction capital reserve' instead of recognising goodwill/capital reserve.

Our views

The amendment would help ensure there is uniformity in the accounting for such arrangements, and carries forward one of the internationally followed practises.

Impact

It is a welcome step that the ICAI is looking to reduce the number of differences between Ind AS and IFRS when they are in the process of finalising the standards for consideration and recommendation by the National Advisory Committee on Accounting Standards (NACAS) and the MCA for notification. This will bring Ind AS closer to IFRS and can go a long way in helping ensure global acceptability of Indian financial statements when prepared using these standards and bring India closer to full convergence.

Next Steps

The IFRS have recently incorporated new standards e.g. IFRS 15, *Revenue from Contracts with Customers* and IFRS 9, *Financial Instruments*. We expect the ICAI will release exposure drafts to incorporate these latest standards into the Ind AS framework. We also expect the NACAS and the MCA to start reviewing these draft standards and notify the final Ind AS standards in the coming months. The ICAI, NACAS and MCA should work towards having bare minimum carve-outs from IFRS.

Find out more

For details of these two proposals, click ED-17 September 2014 and ED - 24 September 2014

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Introducing Voices on Reporting

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

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 Accounting and Auditing Update or First Note

The September 2014 edition of the Accounting and Auditing Update provides insights into actions that can be taken by regulators and highlights related accounting and reporting considerations that impact companies primarily in the pharmaceutical sector. We also cover two articles on the Companies Act, 2013 where we share some practical experience and implementation challenges – one is on corporate social responsibility and second on the related party transactions. Under the International Financial Reporting Standards, we cover the status of the lease accounting project and some of the narrow scope but significant amendments issued by the International Accounting Standards Board. As always, we have also covered key regulatory developments during the recent past.

SEBI's recent amendments of clause 49

Clause 49 of the Equity Listing Agreement (ELA) was amended by the Securities and Exchange Board of India (SEBI) in April 2014, and the revised requirements were to be applicable from 1 October 2014. Since then, the SEBI has received various representations from industry associations, companies and other market participants seeking clarifications and interpretation relating to certain of these amended provisions of clause 49. Additionally, SEBI recently sought feedback on the status of preparedness of the top 500 listed companies by market capitalisation for ensuring timely compliance with the clause 49.

To address the concerns and help the listed companies to ensure compliance with the revised provisions of the clause 49, the SEBI has made further amendments to some of the provisions of clause 49.

Our First Notes summarises these amendments.

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