

Ind AS Transition Facilitation Group (ITFG) Clarification Bulletin 3

‘Ind AS Transition Facilitation Group’ (ITFG) of Ind AS (IFRS) Implementation Committee has been constituted for providing clarifications on timely basis on various issues related to the applicability and /or implementation of Ind AS under the Companies (Indian Accounting Standards) Rules, 2015, raised by preparers, users and other stakeholders.

At the third and fourth (3rd and 4th) meeting of Ind AS Transition Facilitation Group (ITFG) held on May 23, 2016 and June 22, 2016, respectively at Mumbai, issues received from some members were discussed. The Group after due deliberations decided to issue following clarifications¹ on the issues considered at the meetings:

Issue 1

Companies which have chosen for voluntary adoption of Ind AS from the financial year 2015-16 do not have clear format that should be used for the preparation of financial statements. In the absence of any specific format, whether a company may apply Ind AS based Schedule III (i.e. the Division II of Schedule III notified by MCA)?

Response

The Ministry of Corporate Affairs, by notification dated April 6, 2016, amended Schedule III by incorporating Division-II for preparation of financial statements as per Ind AS with effect from the date of publication in the Official Gazette i.e. April 6, 2016. It may be noted that as on March 31, 2016, there was no specific Schedule prescribed under the Companies Act 2013, for companies voluntarily adopting Ind AS from financial year 2015-16. However, it may further be noted that there is no prohibition in amended Schedule III incorporating Division II for its early or voluntary adoption.

In view of the above, a company voluntarily adopting Ind AS from financial year 2015-16 may use the format specified in Division II of Revised Schedule III (which is in compliance with Ind AS notified as Companies (Indian Accounting Standards) Rules, 2015) for the preparation of financial statements as per Ind AS for financial year 2015-16, as going forward also the same format shall be applied.

Issue 2

Company A is a Core Investment Company (CIC) having net worth of more than 500 crore as on March 31, 2014. During the year 2014-15, the Reserve Bank of India (RBI) had exempted Company A from certain regulations/directions governing CIC in India.

¹Clarifications given or views expressed by the ITFG represent the views of the members of the Ind AS Transition Facilitation Group (ITFG) and are not necessarily the views of the Ind AS (IFRS) Implementation Committee or the Council of the Institute. The clarifications/views are based on the accounting principles as on the date the Group finalises the particular clarification. The date of finalisation of each clarification is indicated along with the clarification. The clarification must, therefore, be read in the light of any amendments and/or other developments subsequent to the issuance of clarifications by the Group.

Whether Company A (exempted CIC) will be regarded as Non-Banking Financial Company (NBFC) for the purpose of applicability of Ind AS?

Response

Rule 2(g) of Companies (Indian Accounting Standards) Rules, 2015, read with Companies (Indian Accounting Standards) (Amendment) Rules, 2016, states as follows:

“(g) “Non-banking Financial Company” means a Non-Banking Financial Company as defined in clause (f) of section 45-I of the Reserve Bank of India Act, 1934 and includes Housing Finance Companies, Merchant Banking Companies, Micro Finance Companies, Mutual Benefit Companies, Venture Capital Fund Companies, Stock Broker or Sub-broker Companies, Nidhi Companies and Chit Companies, Securitisation and Reconstruction Companies, Mortgage Guarantee Companies, Pension Fund Companies, Asset Management Companies and **Core Investment Companies.**”

It may be noted from above, that core investment companies are specifically included in the definition of NBFC. Accordingly, exempted CIC will be regarded as ‘NBFC’ for the purpose of roadmap for implementation of Ind AS irrespective of the fact that RBI may have given some exemptions to certain class of core investment companies from its regulations.

Further, as per rule 4 of Companies (Indian Accounting Standards) Rules, 2015, read with the Companies (Indian Accounting Standards) (Amendment) Rules, 2016, NBFCs having net worth of more than 500 crore shall comply with Ind AS for accounting periods beginning on or after the 1st April, 2018, with comparatives for the periods ending on 31st March, 2018.

In view of the above, in the given case, Company A will be required to apply Ind AS from the financial year 2018-19. It may further be noted that it cannot voluntarily adopt Ind AS before 1st April 2018.

Issue 3

XY Ltd. is being covered under Phase I of Ind AS and needs to apply Ind AS from the financial year 2016-17. It has two businesses, Business X and Business Y. As per Accounting Standards, the financial statements of the Company are prepared in Indian Rupee (“INR”), as required by the Companies Act 2013 and thereby, all transactions of both business X as well as business Y are recorded and measured in INR.

Under Ind AS, the functional currency of the Business X is concluded to be US Dollar (“USD”) while the functional currency of the Business Y is concluded to be INR. In which currency, Company XY will prepare its financial statements as per Ind AS?

Response

As per paragraph 8 of Ind AS 21, *The Effects of Changes in Foreign Exchange Rates*, functional currency is the currency of the primary economic environment in which the entity operates.

Further, paragraph 17 of Ind AS 21 states that:

“In preparing financial statements, each entity - whether a stand-alone entity, an entity with foreign operations (such as a parent) or a foreign operation (such as a subsidiary or branch)—determines its functional currency in accordance with paragraphs 9–14 of Ind AS 21.”

Paragraphs 9-14 of Ind AS 21, elaborate the factors that need to be considered by an entity while determining its functional currency.

In view of the above, it is concluded that 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. Accordingly, in the given case, if XY Ltd. after applying paragraphs 9-14 of Ind AS 21, concludes that its functional currency is USD at the entity level, then it shall prepare its financial statements as per USD.

Issue 4

Company B Ltd. is an associate company of Company A Ltd. Company X Ltd. is the holding company of Company A Ltd. Company X Ltd. has decided to adopt Ind AS voluntarily from 2015-16.

Whether Company A Ltd. and Company B Ltd. are statutorily required to comply with Ind AS from financial year 2015-16?

Response

As per the Companies (Indian Accounting Standards) Rules, 2015, read with the Companies (Indian Accounting Standards) (Amendment) Rules, 2016, dated 30th March, 2016, **any company and its holding, subsidiary, joint venture or associate company** may comply with the Indian Accounting Standards (Ind AS) for financial statements for accounting periods beginning on or after 1st April, 2015, with the comparatives for the periods ending on 31st March, 2015, or thereafter.

Since, Company X Ltd. has adopted Ind AS voluntarily from financial year 2015-16, Company A Ltd. being subsidiary of Company X Ltd. shall comply with Ind AS from the financial year 2015-16 as per the roadmap.

As per paragraph 3 of Ind AS 28, *Investments in Associates and Joint Ventures*, an associate is an entity over which the investor has significant influence.

Ind AS 28 defines ‘*Significant influence*’ as the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies.

Paragraph 5 of Ind AS 28, states as follows:

“If an entity holds, directly or indirectly (eg through subsidiaries), 20 per cent or more of the voting power of the investee, it is presumed that the entity has significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the entity holds, directly or indirectly (eg through subsidiaries), less than 20 per cent of the voting power of the investee, it is presumed that the entity does not have significant influence, unless such influence can be clearly demonstrated. A substantial or majority ownership by another investor does not necessarily preclude an entity from having significant influence.”

In the given case, Company B Ltd. is a direct associate company of Company A Ltd. but not of Company X Ltd. However, Company X Ltd, through its subsidiary (i.e., Company B Ltd.), has significant influence over Company B Ltd., indirectly.

In view of the above requirements, Company B Ltd. shall also comply with Ind AS from the financial year 2015-16.

In other words, if a parent company voluntarily or mandatorily adopts Ind AS then its holding, subsidiary, joint venture or associate company whether through direct or indirect association shall comply Ind AS from the financial year in which the parent company starts complying with Ind AS.

Issue 5

Company A Ltd. has invested 26% in Company B Ltd. and accounted Company B as an associate under Companies (Accounting Standards) Rule, 2006. Company A Ltd. is required to comply with Ind AS from financial year 2016-17.

Company C Ltd. owns share warrants that are convertible into equity shares of Company B Ltd. that have potential, if exercised, to give additional voting power to Company C Ltd. over the financial and operating policies of Company B Ltd. As per the requirements of Ind AS 28, it has been concluded that Company B Ltd. is an associate company of Company C Ltd.

Company A concluded that it has no more significant influence over Company B Ltd under Ind AS.

The above assessments have been done as on April 1, 2015.

However, Company A Ltd. reported Company B Ltd. as an associate company as on March 31, 2016 for statutory reporting requirements under previous GAAP.

Company B Ltd. and Company C Ltd. as a standalone entity do not meet any criteria given in Ind AS roadmap. Whether Company B is required to comply with Ind AS?

Response

Sub-rule (2) of Rule 2 of the Companies (Indian Accounting Standards) Rules, 2015, provides as follows:

“Words and expressions used herein and not defined in these rules but defined in the Act shall have the same meaning respectively assigned to them in the Act”

The term ‘associate’ has been defined in Ind AS 28 which is notified as the part of the Companies (Indian Accounting Standards) Rules, 2015.

As per paragraph 3 of Ind AS 28, *Investments in Associates and Joint Ventures*, an associate is an entity over which the investor has significant influence.

Ind AS 28 defines ‘*Significant influence*’ as the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies.

Paragraph 5 of Ind AS 28, states as follows:

“5 If an entity holds, directly or indirectly (eg through subsidiaries), 20 per cent or more of the voting power of the investee, it is presumed that the entity has significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the entity holds, directly or indirectly (eg through subsidiaries), less than 20 per cent of the voting power of the investee, it is presumed that the entity does not have significant influence, unless such influence can be clearly demonstrated. A substantial or majority ownership by another investor does not necessarily preclude an entity from having significant influence.”

Paragraph 7 of Ind AS 28 provide as follows:

“7 An entity may own share warrants, share call options, debt or equity instruments that are convertible into ordinary shares, or other similar instruments that have the potential, if exercised or converted, to give the entity additional voting power or to reduce another party’s voting power over the financial and operating policies of another entity (ie potential voting rights). The existence and effect of potential voting rights that are currently exercisable or convertible, including potential voting rights held by other entities, are considered when assessing whether an entity has significant influence. Potential voting rights are not currently exercisable or convertible when, for example, they cannot be exercised or converted until a future date or until the occurrence of a future event.”

As per Notification G.S.R 680(E) dated 4th September, 2015 issued by Ministry of Corporate Affairs (MCA), after rule 4 of Companies (Accounts) Rules, 2014, the following rule has been inserted:

“4A Forms and items contained in financial statements – The financial statements shall be in the form specified in Schedule III to the Act and comply with Accounting Standards or Indian Accounting Standards as applicable:

Provided that the items contained in the financial statements shall be prepared in accordance with the definitions and other requirements specified in the Accounting Standards or the Indian Accounting Standards, as the case may be.”

In view of above requirements, consistent approach would be to consider the definitions given in Ind AS both for the purpose of preparing financial statements and determining the relationship with another entity (i.e. subsidiary, associate, joint venture etc.) for the purpose of applicability of Ind AS.

In the present case, by applying the relevant requirements of Ind AS 28, it has been concluded that Company B Ltd. is an associate company of Company C Ltd. since Company C Ltd. has potential voting rights over Company B Ltd.

In the given scenario, in accordance with Ind AS, Company B Ltd. also ceases to be an associate of Company A Ltd. Therefore, Company B Ltd. need not to comply with Ind AS from the financial year 2016-17 though the company was an associate company of Company A Ltd. under previous reporting framework.

If Company C Ltd. voluntarily complies with Ind AS or meets any specified criteria on standalone basis, then Company B Ltd. being its associate company as per Ind AS 28 shall comply Ind AS from the same financial year from which Company C Ltd. starts preparing financial statements as per Ind AS.

Issue 6

Company X, on a standalone basis, has a net worth of above Rs. 500 crore and hence required to comply with Ind AS from financial year 2016-17. Company Y (listed entity), on a standalone basis, has net worth of above INR 250 crore but below Rs. 500 crore and therefore required to comply with Ind AS from financial year 2017-18.

Company X acquires shares of Company Y resulting in Company Y becoming an associate of Company X on October 31, 2016, but before approval of the results for the quarter ended September 2016.

Whether Company Y will be required to comply with Ind AS from financial year 2016-17 or it will comply from financial year 2017-18? If the response is that compliance is from the financial year 2016-17, would the financial results of Company Y for the quarter ended September 30, 2016 be prepared in accordance with Ind AS?

Response

Rule 4(1)(ii) of Companies (Indian Accounting Standards) Rules, 2015, states as under:

(ii) the following companies shall comply with the Indian Accounting Standards (Ind AS) for the accounting periods beginning on or after 1st April, 2016, with the comparatives for the periods ending on 31st March, 2016, or thereafter, namely:-

(a) companies whose equity or debt securities are listed or are in the process of being listed on any stock exchange in India or outside India and having net worth of rupees five hundred crore or more;

(b) companies other than those covered by sub-clause (a) of clause (ii) of sub-rule (1) and having net worth of rupees five hundred crore or more;

(c) holding, subsidiary, joint venture or associate companies of companies covered by sub-clause (a) of clause (ii) of sub-rule (1) and sub-clause (b) of clause (ii) of sub-rule (1) as the case may be; and”.

In accordance with the above, it may be noted that holding, subsidiary, joint venture, associate companies of companies falling under any of the thresholds specified in Rule 4(1)(ii) are required to comply with Ind AS from financial year 2016-17 or 2017-18, as the case may be.

In the given case, Company X is required to adopt Ind AS from financial year 2016-17, since net worth of Company X is more than INR 500 crore. Company X has acquired shares of Company Y resulting in Company Y becoming an associate of Company X during the financial year 2016-17. Accordingly, Company Y will prepare Ind AS financial statements for the year ending March 31, 2017.

As far as the quarterly results are concerned, since, Company Y has become an associate as on October 31, 2016, Company Y will prepare Ind AS financial statements from the quarter ending December 2016 onwards.

Issue 7

Company X (Listed entity) has a net worth of above INR 500 crore and hence required to comply with Ind AS from financial year 2016-17. Company Y (Unlisted entity), on a standalone basis, has net worth below INR 250 crore and hence it is not required to comply with Ind AS. Company Y acquires shares of Company X during financial year 2016-17, whereby Company Y becomes the holding company of Company X.

Whether Company Y will be required to comply with Ind AS from financial year 2016-17, given that it has now become a holding company of Company X during FY 2016-17?

Response

Rule 4(1)(ii) of Companies (Indian Accounting Standards) Rules, 2015, states as under:

(ii) the following companies shall comply with the Indian Accounting Standards (Ind AS) for the accounting periods beginning on or after 1st April, 2016, with the comparatives for the periods ending on 31st March, 2016, or thereafter, namely:-

(a) companies whose equity or debt securities are listed or are in the process of being listed on any stock exchange in India or outside India and having net worth of rupees five hundred crore or more;

(b) companies other than those covered by sub-clause (a) of clause (ii) of sub-rule (1) and having net worth of rupees five hundred crore or more;

(c) holding, subsidiary, joint venture or associate companies of companies covered by sub-clause (a) of clause (ii) of sub-rule (1) and sub-clause (b) of clause (ii) of sub-rule (1) as the case may be; and”.

In accordance with the above, it may be noted that holding, subsidiary, joint venture, associate companies of companies falling under any of threshold specified Rule 4(1)(ii) are required to comply with Ind AS from financial year 2016-17 or 2017-18, as the case may be.

In the given case, Company X is required to adopt Ind AS from financial year 2016-17, since net worth of Company X is more than INR 500 crore. Company Y has acquired shares of Company X resulting in Company Y becoming holding company of Company X during the financial year 2016-17. Accordingly, Company Y will prepare Ind AS financial statements for the year ending March 31, 2017.

Issue 8

As on March 31, 2014, Company A is a listed company and has a net worth of 50 crore. As on March 31, 2015, the company is no more a listed company. Whether Company A is required to comply with Ind AS from financial year 2017-18.

Response

Rule 4(1)(iii) of the Companies (Indian Accounting Standards) Rules, 2015, states as under:

“(iii) the following companies shall comply with the Indian Accounting Standards (Ind AS) for the accounting periods beginning on or after 1st April, 2017, with the comparatives for the periods ending on 31st March, 2017, or thereafter, namely:-

(a) companies whose equity or debt securities are listed or are in the process of being listed on any stock exchange in India or outside India and having net worth of less than rupees five hundred crore;

(b) companies other than those covered in clause (ii) of sub-rule (1) and subclause (a) of clause (iii) of sub-rule (1), that is, unlisted companies having net worth of rupees two hundred and fifty crore or more but less than rupees five hundred crore.

(c) holding, subsidiary, joint venture or associate companies of companies covered under sub-clause (a) of clause (iii) of sub-rule (1) and sub-clause (b) of clause (iii) of sub-rule (1), as the case may be”.

Further, Rule 4(2) of the Companies (Indian Accounting Standards) Rules, 2015, states as under:

“(2) For the purposes of calculation of net worth of companies under sub-rule (1), the following principles shall apply, namely:-

(a) the net worth shall be calculated in accordance with the stand-alone financial statements of the company as on 31st March, 2014 or the first audited financial statements for accounting period which ends after that date;

(b) for companies which are not in existence on 31st March, 2014 or an existing company falling under any of thresholds specified in sub-rule (1) for the first time after 31st March, 2014, the net worth shall be calculated on the basis of the first audited financial statements ending after that date in respect of which it meets the thresholds specified in sub-rule (1).

Explanation.- For the purposes of sub-clause (b), the companies meeting the specified thresholds given in sub-rule (1) for the first time at the end of an accounting year shall apply Indian Accounting Standards (Ind AS) from the immediate next accounting year in the manner specified in sub-rule (1). ”

In view of the above requirements, it may be noted that immediately before the mandatory applicability date, if the threshold criteria for a company are not met, then it shall not be required to comply with Ind AS, irrespective of the fact that as on March 31, 2014, the criteria was met.

In the given case, before the mandatory applicable date (i.e 2017-18), Company A ceases to be a listed company. Accordingly, it will not be required to apply Ind AS from FY 2017-18.

Issue 9

ABC Ltd. is covered under Ind AS roadmap and required to prepare its financial statements as per Ind AS from financial year 2016-17 with comparatives for financial year 2015-16. The date of transition to Ind AS is April 1, 2015. The Company has chosen to continue with the carrying value for all of its property, plant and equipment as recognised in the financial statements as at the date of transition to Ind AS, measured as per the previous GAAP. The Company has recorded capital spares in its previous GAAP financial statements as a part of inventory.

How should the capital spares be accounted under Ind AS on the date of transition to Ind AS if the Company chooses to apply the previous GAAP as deemed cost exemption?

Response

As per paragraph 8 of Ind AS 16, *Property, Plant and Equipment*, items such as spare parts are to be recognised in accordance with Ind AS 16, when they meet the definition of ‘property, plant and equipment’. Otherwise such items are classified as inventory.

As per Ind AS 16, ‘property, plant and equipment’, are tangible items that:

- (a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
- (b) are expected to be used during more than one period.

Paragraph 7 of Ind AS 16, *Property, Plant and Equipment*, states as under:

“The cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:

- (a) it is probable that future economic benefits associated with the item will flow to the entity; and
- (b) the cost of the item can be measured reliably.”

Therefore, if an item of spare part meets the definition of ‘property, plant and equipment’ as mentioned above and satisfies the recognition criteria as per paragraph 7 of Ind AS 16, such an item of spare has to be recognised as property, plant and equipment. If that spare part does not meet the definition and recognition criteria as cited above that spare is to be recognised as inventory.

Paragraph 10 of Ind AS 101, *First-time Adoption of Indian Accounting Standards*, inter alia, states that an entity, shall in its opening Ind AS Balance Sheet, recognise all assets and liabilities whose recognition is required by Ind AS.

As per paragraph D7AA, once the company chooses previous GAAP as deemed cost as provided in paragraph D7AA of Ind AS 101, it is not allowed to adjust the carrying value of property, plant and equipment for any adjustments other than those in accordance with paragraph D21 and D21A of Ind AS 101. In this case, a question arises whether the company may capitalise spares as a part of property, plant and equipment on the date of transition to Ind AS. It may be noted deemed cost exemption as the previous GAAP is in respect of carrying value of property, plant and equipment capitalised under previous GAAP on the date of transition to Ind AS. This condition does not prevent a company to recognise an asset whose recognition is required by Ind AS on the date of transition.

In the given case, the capital spares were recognised as inventory under previous GAAP and they were not appearing under carrying amount of PPE.

In view of the above, it is clear that ABC Ltd. should recognise ‘capital spares’ if they meet definition of PPE as on the date of transition, in addition to continuing carrying value of PPE as per paragraph D7AA of Ind AS 101.

Issue 10

XYZ Ltd. had obtained a long term foreign currency loan and had availed option given in paragraph 46/46A of AS 11, *The Effects of Changes in Foreign Exchange Rates* under previous GAAP. Accordingly, exchange gain/loss on such foreign currency loan had been added to or deducted from the cost of fixed assets.

XYZ Ltd. is a first time adopter of Ind AS from April 1, 2016. The Company wants to avail the option available under paragraph D13AA of Ind AS 101, i.e., to continue the policy adopted for accounting for exchange difference arising from translation of long-

term foreign currency monetary items recognised in the previous GAAP financial statements.

The entity has also entered into foreign currency swap transaction for such long term foreign currency items. The swaps fall within the definition of cash flow hedge. As per Ind AS 109, *Financial Instruments*, in case of cash flows hedge, portion of gain or loss on the hedging instrument that is determined to be an effective hedge shall be recognized in the Other Comprehensive Income (OCI) and ineffectiveness gain or loss shall be recognized in the profit or loss.

How to give the effect of swaps in the financial statements, as gain/loss on hedged item is considered in the fixed assets whereas gain/loss on hedging instrument as per Ind AS 109 is either recognised in OCI or in profit and loss?

Response

Paragraph D13AA of Ind AS 101 provides that a first-time adopter may continue the 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 as per the previous GAAP.

Paragraph 6.1.1 of Ind AS 109 states as under:

“The objective of hedge accounting is to represent, in the financial statements, the effect of an entity’s risk management activities that use financial instruments to manage exposures arising from particular risks that could affect profit or loss (or other comprehensive income, in the case of investments in equity instruments for which an entity has elected to present changes in fair value in other comprehensive income in accordance with paragraph 5.7.5).”

In the present case, the entity has decided to avail the option available under paragraph D13AA of Ind AS 101. It may be noted that if an entity avails the exemption specified in paragraph D13AA then it has no corresponding foreign currency exposure that affects profit or loss as it capitalizes the exchange differences to the cost of the asset.

In view of the above, hedge accounting under Ind AS 109 will not be applicable for foreign currency swaps against an item, if for that item, the entity avails the option available under paragraph D13AA of Ind AS 101. Hence, such derivatives will be considered as held for trading and any change in fair value will be recognised in profit or loss.

Issue 11

Can a company elect the option available under Para D7AA of Ind AS 101 for capital work in progress items?

Response

Para D7AA of Ind AS 101, *First-time Adoption of Indian Accounting Standards*, states as under:

“Where there is no change in its functional currency on the date of transition to Ind ASs, a first-time adopter to Ind ASs may elect to continue with the carrying value for all of its property, plant and equipment as recognised in the financial statements as at the date of transition to Ind ASs, measured as per the previous GAAP and use that as its deemed cost as at the date of transition after making necessary adjustments in accordance with paragraph D21 and D21A, of this Ind AS. For this purpose, if the financial statements are consolidated financial statements, the previous GAAP amount of the subsidiary shall be that amount used in preparing and presenting consolidated financial statements. 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. If an entity avails the option under this paragraph, no further adjustments to the deemed cost of the property, plant and equipment so determined in the opening balance sheet shall be made for transition adjustments that might arise from the application of other Ind ASs. This option can also be availed for intangible assets covered by Ind AS 38, Intangible Assets and investment property covered by Ind AS 40, Investment Property.”

In accordance with the above, it may be noted that a company may elect to choose previous GAAP carrying value for all the items of PPE as its deemed cost when there is no change in its functional currency on the date of transition to Ind AS.

Capital work in progress is in the nature of property, plant and equipment under construction and accordingly, provisions of Ind AS 16, *Property, Plant and Equipment* apply to it.

Accordingly, in the given case, option under paragraph D7AA of Ind AS 101 is available with regard to capital work in progress also.

Issue 12

Company A has made investment in subsidiary S Ltd. Company A elects to measure the investment in S Ltd. at fair value on the date of transition as per Ind AS 101. Can Company A opt to carry the investment in S Ltd. at cost after the date of transition as per Ind AS 27?

Response

Paragraph D15 of Ind AS 101, *First-time Adoption of Indian Accounting Standards* states as under:

“If a first-time adopter measures such an investment at cost in accordance with Ind AS 27, it shall measure that investment at one of the following amounts in its separate opening Ind AS Balance Sheet:

(a) cost determined in accordance with Ind AS 27; or

(b) deemed cost. The deemed cost of such an investment shall be its:

(i) fair value at the entity's date of transition to Ind ASs in its separate financial statements; or

(ii) previous GAAP carrying amount at that date.

A first-time adopter may choose either (i) or (ii) above to measure its investment in each subsidiary, joint venture or associate that it elects to measure using a deemed cost."

Further, paragraph 10 of Ind AS 27, *Separate Financial Statements*, inter-alia states as under:

"When an entity prepares separate financial statements, it shall account for investments in subsidiaries, joint ventures and associates either:

(a) at cost, or

(b) in accordance with Ind AS 109."

In accordance with the above, it may be noted that for a first-time adopter cost of investment in a subsidiary shall be one of the following amounts:

- 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 a company chooses to measure its investment at fair value at the date of transition then that is deemed to be cost of such investment for the company and, therefore, it shall carry its investment at that amount (i.e. fair value at the date of transition) after the date of transition.

Accordingly, in the given case, Company A can carry investment in S Ltd. at transition date fair value which is deemed to be its cost as per paragraph 10 of Ind AS 27.

Issue 13

Paragraph 7AA of Ind 38, *Intangible Assets* read with paragraph D22 of Ind AS 101, *First-time Adoption of Indian Accounting Standards* permits revenue based amortisation for the 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. However, Schedule II to the Companies Act, 2013, permits revenue based amortisation for such intangible asset without any reference to any financial year. Whether a company is permitted to follow revenue based amortisation even for such new arrangements entered into after Ind AS become applicable?

Response

Paragraph D22 of Ind AS 101, *inter alia*, states as follows:

“D22 A first-time adopter may apply the following provisions while applying the Appendix A to Ind AS 11:

- (i) Subject to paragraph (ii), changes in accounting policies are accounted for in accordance with Ind AS 8, i.e. retrospectively, except for the policy adopted for amortization of intangible assets arising from service concession arrangements related to toll roads recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP.....”

Paragraph D7AA of Ind AS 38, *Intangible Assets*, states as follows:

“7AA The amortisation method specified in this Standard does not apply to an entity that opts to amortise the 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 as per the exception given in paragraph D22 of Appendix D to Ind AS 101.”

Schedule II to the Companies Act, 2013, provides that for intangible assets, the provisions of the accounting standards applicable for the time being in force shall apply, except in case of intangible assets (Toll Roads) created under ‘Build, Operate and Transfer’, ‘Build, Own, Operate and Transfer’ or any other form of public private partnership route in case of road projects. Amortisation in such cases may be done on the basis of revenue as specified Schedule II.

Paragraph 7AA of Ind 38 read with paragraph D22 of Ind AS 101, specifically provides exemption for 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 as per the previous GAAP, i.e., as per Schedule II to the Companies Act, 2013, considering the requirements contained in that Schedule. Companies (Accounts) Rules, 2014 prescribes to follow Ind AS in preparation of financial statements.

Hence, in harmonisation of Rules and Ind AS 38 read with Ind AS 101, principles of Ind AS 38 should be followed for all service concession arrangements including roll roads once Ind AS is applicable to an entity.

Issue 14

A Ltd. (first-time adopter to Ind AS) chooses to measure its property, plant and equipment by applying Ind AS 16, *Property, Plant and Equipment* retrospectively. Under previous GAAP, A Ltd. had been applying depreciation rates specified in Schedule XIV to the Companies Act, 1956. Whether A Ltd. is required to recompute depreciation based on useful lives from the date of initial capitalisation of property, plant and equipment or

it will have to apply depreciation rates applied under previous GAAP till the date of opening balance sheet.

Response

Ind AS 101 requires retrospective application of Ind AS effective at the end of a first-time adopter's first Ind AS reporting period. However, as an exception to this rule, Ind AS 101, *inter alia*, provides deemed cost exemption, wherein as at the date of transition to Ind AS, a first time adopter may elect to measure all of its items of property, plant and equipment (PPE) at the carrying amounts as per its previous GAAP.

In case the first-time adopter does not elect to choose deemed cost exemption, then the requirements of Ind AS 16 would have to be applied as if the first-time adopter had always applied the Standard. Accordingly, PPE will be measured based on historical cost determined in accordance with Ind AS 16.

Paragraph 50 of Ind AS 16, *Property, Plant & Equipment* states as under:

"The depreciable amount of an asset shall be allocated on a systematic basis over its useful life."

Further, paragraph 57 of Ind AS 16, states as follows:

"The useful life of an asset is defined in terms of the asset's expected utility to the entity. The asset management policy of the entity may involve the disposal of assets after a specified time or after consumption of a specified proportion of the future economic benefits embodied in the asset. Therefore, the useful life of an asset may be shorter than its economic life. The estimation of the useful life of the asset is a matter of judgement based on the experience of the entity with similar assets."

As per the above requirements, it may be noted that as per Ind AS 16, a company is required to compute depreciation based on an assessment of useful lives of an asset.

Further, paragraph 13 & 14 of Ind AS 101, *First-time Adoption of Indian accounting Standards* states as follows:

"13 This Ind AS prohibits retrospective application of some aspects of other Ind ASs. These exceptions are set out in paragraphs 14–17 and Appendix B."

"14 An entity's estimates in accordance with Ind ASs at the date of transition to Ind ASs shall be consistent with estimates made for the same date in accordance with previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those estimates were in error."

In accordance with the above paragraphs, it may be noted while transitioning to Ind AS, a first-time adopter's estimate of depreciation under previous GAAP can only be changed if those estimates were in error. However, when a company has been computing depreciation as per

rates prescribed under Schedule XIV of Companies Act, 1956, then it has not estimated the useful life of an asset but has depreciated its assets as per the minimum requirements of law.

Accordingly, when a first-time adopter chooses to measure its PPE by retrospective application of Ind AS 16, then it will be required to re-compute depreciation by assessing the useful life of an asset in accordance with Ind AS 16 which is consistent with Schedule II to the Companies Act, 2013.