

Ind AS Transition Facilitation Group (ITFG) Clarification Bulletin 12

'Ind AS Transition Facilitation Group' (ITFG) of Ind AS 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. Ind AS Transition Facilitation Group (ITFG) considered some issues received from members and decided to issue following clarifications¹ on October 23, 2017:

Issue 1: (i) ABC Ltd. is covered under Phase II of Ind AS roadmap and is required to apply Ind AS from financial year 2017-18. It has certain immovable properties such as land or building. Whether ABC Ltd. is allowed to use revaluation model under Ind AS 16, *Property, Plant and Equipment* for such immovable properties instead of cost model in its first Ind AS financial statements prepared for the period ending 31st March 2018.

(ii) Whether ABC Ltd. can opt for cost model for some class of property, plant and equipment and apply revaluation model for other class of property, plant and equipment in its first Ind AS financial statements prepared for the period ending 31st March 2018.

Response: (i) An entity will first be required to evaluate that whether the land and building that it holds is an investment property or its property, plant and equipment (PPE).

Ind AS 40, *Investment Property* provides that *Investment property is property (land or a building—or part of a building—or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than for:*

- (a) use in the production or supply of goods or services or for administrative purposes; or*
- (b) sale in the ordinary course of business.*

Further Ind AS 16, *Property, Plant and Equipment*, states that-

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.*

In accordance with the above, if land or building is classified as PPE, then the same shall be initially measured at cost and for subsequent measurement the entity has the option to choose cost model or revaluation model as per paragraph 29 of Ind AS 16 as stated below:

¹ Clarifications given or views expressed by the Ind AS Transition Facilitation Group (ITFG) represent the views of the members of the ITFG and are not necessarily the views of the Ind AS 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

“An entity shall choose either the cost model in paragraph 30 or the revaluation model in paragraph 31 as its accounting policy and shall apply that policy to an entire class of property, plant and equipment.”

However, if land or building has been held to earn rentals or for capital appreciation or both then the same shall be classified as investment property and only cost model as per paragraph 30 of Ind AS 40 can be used.

As per paragraph 20 of Ind AS 40, *“An investment property shall be measured initially at its cost.”* Further paragraph 30 requires that, *“An entity shall adopt as its accounting policy the **cost model prescribed in paragraph 56** to all of its investment property.”*

Further, paragraph 56 of Ind AS 40 states as follows:

Cost model

56 After initial recognition, an entity shall measure all of its investment properties in accordance with Ind AS 16’s requirements for cost model, other than those that meet the criteria to be classified as held for sale (or are included in a disposal group that is classified as held for sale) in accordance with Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations. Investment properties that meet the criteria to be classified as held for sale (or are included in a disposal group that is classified as held for sale) shall be measured in accordance with Ind AS 105.

(ii) As per paragraph 31 of Ind AS 16, *“After recognition as an asset, an item of property, plant and equipment whose fair value can be measured reliably shall be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period.”*

Further, paragraphs 36 and 37 of Ind AS 16, *inter alia*, state:

36 If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs shall be revalued.”

37 A class of property, plant and equipment is a grouping of assets of a similar nature and use in an entity’s operations... ..

In accordance with the above, it may be noted that the standard requires that if revaluation model is chosen then that should be applied to the entire class and not to an individual item of property, plant and equipment. Accordingly, in the given case, the entity may elect to opt for revaluation model for a particular class of assets and cost model for another class of assets which are classified as property, plant and equipment.

Issue 2: ABC Ltd. is a first-time adopter of Ind AS from the financial year 2016-17. It had received the government grant from the Central Government during the financial year 2012-13 to purchase a fixed asset. The grant received from the Government was deducted from the carrying amount of fixed asset as permitted under previous GAAP, i.e. AS 12, *Accounting for Government Grants*. ABC Ltd. has opted for the option under paragraph D5 of Ind AS 101, *First-time Adoption of Indian Accounting Standards* and chosen to measure the item of PPE at its fair value and use that as its deemed cost on the date of transition to Ind AS. As per Ind AS 20, *Accounting for Government Grants and Disclosure of Government Assistance*, such a grant is required to be accounted by setting up the grant as deferred income on the date of transition and deducting the grant in arriving at the carrying amount of the asset is not allowed.

In this situation, whether ABC Ltd. is required to adjust the carrying amount of fixed assets as per previous GAAP to reflect accounting treatment of the government grant as per Ind AS 20?

Response: Paragraph D5 of Ind AS 101 states that, *An entity may elect to measure an item of property, plant and equipment at the date of transition to Ind ASs at its fair value and use that fair value as its deemed cost at that date.*

Further, as per paragraph 24 of Ind AS 113, *Fair Value Measurement*, “Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (i.e. an exit price) regardless of whether that price is directly observable or estimated using another valuation technique.”

In accordance with the above, it is pertinent to note that the fair value of the asset that will be derived as per Ind AS 113 will be the exit price that would be received to sell an asset in an orderly transaction and which is a market-based measurement, not an entity-specific measurement.

Accordingly, in the given case, fair value of the asset is independent of the government grant received on the asset and no adjustment with regard to the government grant should be made to the fair value of the property, plant and equipment taken as deemed cost on the date of transition to Ind AS.

Further, Ind AS 101 provides certain mandatory exceptions and voluntary exemptions from retrospective application of some aspects/requirements of Ind AS.

In absence of any mandatory exception applicable in this case, the company shall recognise the asset-related government grants outstanding on the transition date as deferred income in accordance with the requirements of Ind AS 20, *Accounting for Government Grants and Disclosure of Government Assistance* and the resultant adjustment will be made in retained earnings or, if appropriate, another category of equity at the date of transition to Ind AS.

Issue 3: P Ltd. (parent company) has issued a comfort letter to its subsidiary company, S Ltd. S Ltd. was able to obtain funds from the banker on the basis of comfort letter issued by P Ltd.

Whether the same will be accounted for as a financial guarantee contract in accordance with Ind AS 109, *Financial Instruments*?

Response: As per Ind AS 109, financial guarantee contract is, “*A contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.*”

Paragraph B2.5 of Ind AS 109 *inter-alia* states that, “*Financial guarantee contracts may have various legal forms, such as a guarantee, some types of letter of credit, a credit default contract or an insurance contract. Their accounting treatment does not depend on their legal form.*”

In accordance with the above, it may be noted that a significant feature of a financial guarantee contract is the contractual obligation to make specified payment in case of default by the credit holder. As such the contract may not necessarily be called as financial guarantee contract and it may take any name or legal form, however the treatment will be same as that of a financial guarantee contract. If a contract legally meets these requirements, then it would be accounted for as the financial guarantee contract as per Ind AS 109

Accordingly, in the given case, P Ltd. will be required to evaluate as to whether it is contractually obliged to make good the loss in case S Ltd. fails to make the payment. If yes, then such comfort letter would be considered to be a financial guarantee contract and will be accounted for in accordance with Ind AS 109.

Issue 4: PQR Ltd. is covered under phase II of Ind AS Implementation and is required to adopt Ind AS from financial year 2017-18. It had obtained term loan from Bank A in 2013-14 and paid loan processing fees and commitment charges. In May 2017, PQR Ltd. has availed fresh loan from Bank B as take-over of facility i.e. the new loan is sanctioned to pay off the old loan taken from Bank A. The company paid prepayment premium to Bank A to clear the old term loan and paid processing fees to Bank B for the new term loan.

Whether the prepayment premium and the processing fees both will be treated as transaction cost (as per Ind AS 109, *Financial Instruments*) of obtaining the new loan, in the financial statements of PQR Ltd. prepared in accordance with Ind AS for the financial year 2017-18.

Response: As per Appendix A of Ind AS 109, *Financial Instruments*, transaction costs are “*Incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability (see paragraph B5.4.8). An incremental cost is one that*

would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.”

Further paragraph B5.4.8 of Ind AS 109 provides that the *Transaction costs include fees and commission paid to agents (including employees acting as selling agents), advisers, brokers and dealers, levies by regulatory agencies and security exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.*

Paragraph B5.4.2 of Ind AS 109, inter alia, provides that fees that are an integral part of the effective interest rate of a financial instrument include origination fees paid on issuing financial liabilities measured at amortised cost. These fees are an integral part of generating an involvement with a financial liability.

It is assumed that the loan processing fees solely relates to the origination of the new loan (i.e. does not represent loan modification/renegotiation fees), In accordance with the above, the processing fees paid to avail fresh loan from Bank B will be considered as transaction cost in the nature of origination fees of the new loan and will be included while calculating effective interest rate as per Ind AS 109.

Further, as per paragraph 3.3.3 of Ind AS 109, the difference between the carrying amount of a financial liability (or part of a financial liability) extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed, shall be recognised in profit or loss.

Paragraph B3.3.6 of Ind AS 109, provides that if an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognised as part of the gain or loss on the extinguishment.

Since the original loan was prepaid, the prepayment would result in extinguishment of the original loan. As per paragraph 3.3.3 of Ind AS 109 as stated above, the difference between the carrying amount of the financial liability extinguished and the consideration paid shall be recognised in profit or loss. Further paragraph B3.3.6 of Ind AS 109 states that where modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognised as part of the gain or loss on the extinguishment. Accordingly, the prepayment premium shall be recognised as part of the gain or loss on extinguishment of the old loan. Further, the unamortised processing fee related to the old loan will also be required to be charged to the statement of profit and loss.

Issue 5: XYZ Ltd. is a first-time adopter of Ind AS from financial year 2016-17. ABC Ltd. was an associate company of XYZ Ltd. under the previous GAAP and the same was accounted under equity method in the consolidated financial statements of XYZ

Ltd. ABC Ltd. became its subsidiary considering the principles of de-facto control as per the requirements of Ind AS 110, Consolidated Financial Statements.

Before transition to Ind AS, XYZ Ltd. had sold goods to ABC Ltd. at profit margin of 10%, which is being used by ABC Ltd for its operation, i.e., represents property, plant and equipment for ABC Limited. XYZ Ltd. has chosen to avail deemed cost exemption provided in paragraph D7AA of Ind AS 101, First-time Adoption of Indian Accounting Standards, i.e., to continue with carrying value of property, plant and equipment as per the previous GAAP which requires the values appearing in the subsidiary's financial statements to be taken without any adjustment.

Will such unrealised profits existing in the property, plant and equipment at consolidated level require elimination?

Response: Paragraph D7AA of Ind AS 101 states that *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.*

Further, paragraph B86 of Ind AS 110, Consolidated Financial Statements, *inter alia*, states that:

*(c) eliminate in full intra group assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group (**profits or losses resulting from intra group transactions that are recognised in assets, such as inventory and fixed assets, are eliminated in full**). Intra group losses may indicate an impairment that requires recognition in the consolidated financial statements. Ind AS 12, Income Taxes, applies to temporary differences that arise from the elimination of profits and losses resulting from intra group transactions.*

Accordingly, in the given case XYZ Ltd. in its consolidated financial statements will first eliminate the intra group profit of 10% recognised in separate financial statements of ABC Ltd. and then will apply the deemed cost exemption under paragraph D7AA of Ind AS 101.

Issue 6: ABC & Company incorporated in US with limited liability, has established a branch office in India, with the permission of the Reserve Bank of India (RBI), to provide consultancy services in India. The branch office remits the amounts earned by

it to ABC & Co. (i.e. Head office) net of applicable Indian taxes and subject to RBI guidelines.

As on April 1, 2016, it has more than 500 crore balance as “Head office account”. Whether the India branch office of ABC Co. will be required to comply with Ind AS?

Response: As per the roadmap issued by the MCA, “company” as defined in clause (20) of section 2 of the Companies Act, 2013 is required to comply with Ind AS. Section 2(20) of the Act defines company as follows:

“company” means a company incorporated under this Act or under any previous company law;

The branch office of a foreign company established in India is not incorporated under the Act. It is only an establishment of a foreign company in India. The Branch office is just an extension of the foreign company in India.

Further, as per Rule 6 of the Companies (Indian Accounting Standards) Rules, 2015, *“Indian company which is a subsidiary, associate, joint venture and other similar entities of a foreign company shall prepare its financial statements in accordance with the Indian Accounting Standards (Ind AS) if it meets the criteria as specified in sub-rule (1).”*

In accordance with the above, it may be noted that Branch office of a foreign company is not covered under rule 6 as mentioned above. Accordingly, in the given case, the branch office of ABC& Co. is not required to comply with Ind AS.

Issue 7: (i) P Ltd., had obtained a below-market rate of interest loan of INR 10,00,000 from Government as on April 1, 2014 for 5 years. The date of transition to Ind AS for Entity P is April 1, 2016. Paragraph B10 of Ind AS 101, *First-time Adoption of Indian Accounting Standards*, requires a first-time adopter to use its previous GAAP carrying amount of government loans existing at the date of transition to Ind AS as the Ind AS carrying amount of such loans at that date.

Under previous GAAP, the carrying amount was INR 10,00,000 at the date of transition to Ind AS. The amount repayable will be INR 10,05,000 at April 1, 2019. No other payment is required under the terms of the loan and there are no future performance conditions attached to the loan. Whether the exemption under paragraph B10 is only for the date of transition to Ind AS or all the subsequent period till the existing loan is presented i.e. 31.3.2019.

(ii) Further P Ltd., also has deferment of liability payable to government based on agreement i.e. liability similar to sales tax deferment for 10 years, can the P Ltd take exemption under B10 stating it is similar to government loan?

Response: (i) Paragraph B10 of Ind AS 101, *First-time Adoption of Indian Accounting Standards* states as follows:

“B10 A first-time adopter shall classify all government loans received as a financial liability or an equity instrument in accordance with Ind AS 32, Financial Instruments: Presentation. Except as permitted by paragraph B11, a first-time adopter shall apply the requirements in Ind AS 109, Financial Instruments, and Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance, prospectively to government loans existing at the date of transition to Ind ASs and shall not recognise the corresponding benefit of the government loan at a below-market rate of interest as a government grant. Consequently, if a first-time adopter did not, under its previous GAAP, recognise and measure a government loan at a below-market rate of interest on a basis consistent with Ind AS requirements, it shall use its previous GAAP carrying amount of the loan at the date of transition to Ind ASs as the carrying amount of the loan in the opening Ind AS Balance Sheet. An entity shall apply Ind AS 109 to the measurement of such loans after the date of transition to Ind ASs.”

Paragraph 10A of Ind AS 20 states that, *“The benefit of a government loan at a below-market rate of interest is treated as a government grant. The loan shall be recognised and measured in accordance with Ind AS 109, Financial Instruments. The benefit of the below market rate of interest shall be measured as the difference between the initial carrying value of the loan determined in accordance with Ind AS 109, and the proceeds received. The benefit is accounted for in accordance with this Standard. The entity shall consider the conditions and obligations that have been, or must be, met when identifying the costs for which the benefit of the loan is intended to compensate.”*

In accordance with the above, a first-time adopter is required to use its previous GAAP carrying amount of government loans existing at the date of transition to Ind AS as the Ind AS carrying amount of such loans at that date. A first-time adopter applies Ind AS 32, *Financial Instruments: Presentation* to classify such a loan as a financial liability or an equity instrument. It shall apply the requirements of Ind AS 20 and Ind AS 109 prospectively to government loans existing at the date of transition to Ind AS, **unless the necessary information needed to apply the requirements of Ind AS 109 and Ind AS 20, retrospectively was obtained at the time of initially accounting for that loan.** As a result of not applying Ind AS 20 and Ind AS 109 retrospectively to government loans at the date of transition, the corresponding benefit of the government loan at a below-market rate of interest is not recognised as a government grant.

It is pertinent to note that subsequently, the first-time adopter applies Ind AS 109 to such a loan. To do so, the entity calculates the effective interest rate by comparing the carrying amount of the loan at the date of transition to Ind AS with the amount and timing of expected repayments to the government.

In the given case, as per Ind AS 32, the loan meets the definition of a financial liability. P Ltd. uses the previous GAAP carrying amount of the loan at the date of transition to Ind AS as the carrying amount of the loan in the opening Ind AS balance sheet. Further, in order to measure

the loan after the date of transition to Ind AS, the effective interest rate starting from April 1, 2016 shall be calculated.

(ii) As per Ind AS 20, "Government grants are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the entity."

Further, paragraphs 9 and 10 of Ind AS 20 state as follows:

9 The manner in which a grant is received does not affect the accounting method to be adopted in regard to the grant. Thus a grant is accounted for in the same manner whether it is received in cash or as a reduction of a liability to the government.

In a scheme of deferral of sales tax, the amount of sales tax collected by the company from its customers is retained by the company and is required to be repaid after specified years (10 years in the example above). This makes such an arrangement similar in nature to an interest free loan and hence the treatment as mentioned in part (i) above shall also be applied to such balances outstanding at the date of transition.

Issue 8: Company A holds 100% shareholding of Company B. Company B holds 100% shareholding of Company C since 1 April 2000. Pursuant to a court scheme, to be filed in February 2018, Entity C will merge with Entity B during the financial year 2018-19 (i.e. the scheme is expected to be approved during the financial year 2018-2019). All companies (A, B and C) are covered under Phase II of Ind AS and will prepare financial statements for year ending 31 March 2018 as per Ind AS.

In case the appointed date in the scheme is 1 April 2016, would it have any impact on the certificate to be issued by the auditors on compliance of the scheme with Ind AS 103?

Would the response be different in case the transferor and transferee entities are not under common control?

Response: Paragraph 8 and 9 of Ind AS 103, *Business Combinations* states as follows:

"Determining the acquisition date

8 The acquirer shall identify the acquisition date, which is the date on which it obtains control of the acquiree.

The date on which the acquirer obtains control of the acquiree is generally the date on which the acquirer legally transfers the consideration, acquires the assets and assumes the

liabilities of the acquiree—the closing date. However, the acquirer might obtain control on a date that is either earlier or later than the closing date. For example, the acquisition date precedes the closing date if a written agreement provides that the acquirer obtains control of the acquiree on a date before the closing date. An acquirer shall consider all pertinent facts and circumstances in identifying the acquisition date.”

Ind AS 103, *Business Combinations*, prescribes significantly different accounting for business combinations which are not under common control and those under common control. Hence, it is pertinent to note that entity is required to assess whether the business combination is under common control or not.

Business Combination is under common control

Paragraph 8 and 9 of Appendix C to Ind AS 103, *Business Combinations* states as follows:

“8 Business combinations involving entities or businesses under common control shall be accounted for using the pooling of interests method.

9 The pooling of interest method is considered to involve the following:

- (i) The assets and liabilities of the combining entities are reflected at their carrying amounts.*
- (ii) No adjustments are made to reflect fair values, or recognise any new assets or liabilities. The only adjustments that are made are to harmonise accounting policies.*
- (iii) **The financial information in the financial statements in respect of prior periods should be restated as if the business combination had occurred from the beginning of the preceding period in the financial statements, irrespective of the actual date of the combination. However, if business combination had occurred after that date, the prior period information shall be restated only from that date. (Emphasis added)**”*

In accordance with paragraph 9(iii) above, the entity will be required to restate its financial statements as if the business combination had occurred from the beginning of the preceding period in the financial statements.

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

Business Combination is not under common control

For business combinations other than under common control the date of acquisition is the date from which the acquirer obtains control of the acquiree.

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

Issue 9: Company A is covered under Phase II of Ind AS roadmap and is required to apply Ind AS from financial Year 2017-18. Company A acquired Company B as per the scheme of amalgamation sanctioned under the provisions of the Companies Act, 2013. The amalgamation was effective from 1st April, 2015 and was accounted for in the financial year 2015-16 under Indian GAAP.

As per the Scheme, the entire undertaking of Company B including all its assets, liabilities and reserves and surplus stood transferred in Company A. As a result, Company A has taken over assets /liabilities including certain financial instruments.

Under Ind AS, Company A has opted for option under paragraph C1 of Ind AS 101, *First-time Adoption of Indian Accounting Standards*, not to apply Ind AS 103 retrospectively to past business combinations (business combinations that occurred before the date of transition to Ind AS).

Whether Company A would be required to apply Ind AS 109, *Financial Instruments* retrospectively (i.e. from the date of origination of the financial instrument by Company B) to such financial instruments acquired as part of the business combination?

Response: Paragraphs C1 and C4 of Ind AS 101, *First-time Adoption of Indian Accounting Standards*, state as follows:

“C1 - A first-time adopter may elect not to apply Ind AS 103 retrospectively to past business combinations (business combinations that occurred before the date of transition to Ind ASs). However, if a first-time adopter restates any business combination to comply with Ind AS 103, it shall restate all later business combinations and shall also apply Ind AS 110 from that same date.

C4 - If a first-time adopter does not apply Ind AS 103 retrospectively to a past business combination, this has the following consequences for that business combination:

(a) The first-time adopter shall keep the same classification (as an acquisition by the legal acquirer, a reverse acquisition by the legal acquiree, or a uniting of interests) as in its previous GAAP financial statements.

(b) The first-time adopter shall recognise all its assets and liabilities at the date of transition to Ind ASs that were acquired or assumed in a past business combination, other than:

(i) some financial assets and financial liabilities derecognised in accordance with previous GAAP (see paragraph B2); and

(ii) assets, including goodwill, and liabilities that were not recognised in the acquirer's consolidated Balance Sheet in accordance with previous GAAP and also would not qualify for recognition in accordance with Ind ASs in the separate Balance Sheet of the acquiree (see (f)–(i) below).

The first-time adopter shall recognise any resulting change by adjusting retained earnings (or, if appropriate, another category of equity), unless the change results from the recognition of an intangible asset that was previously subsumed within goodwill (see (g) (i) below).

(c) The first-time adopter shall exclude from its opening Ind AS Balance Sheet any item recognised in accordance with previous GAAP that does not qualify for recognition as an asset or liability under Ind ASs.”

In accordance with the above, it may be noted that Ind AS 101 provides an optional exemption not to apply Ind AS retrospectively to business combinations that occurred before the date of transition to Ind AS. If previous business combinations are not restated, the previous acquisition accounting remains unchanged. Carrying amount under previous GAAP of assets acquired and liabilities assumed in an un-restated business combination immediately after the business combination becomes their **deemed cost at that date**.

Paragraph C4(e) of Ind AS 101, states that, “Immediately after the business combination, the carrying amount in accordance with previous GAAP of assets acquired and liabilities assumed in that business combination shall be their deemed cost in accordance with Ind ASs at that date. If Ind ASs require a cost-based measurement of those assets and liabilities at a later date that deemed cost shall be the basis for cost-based depreciation or amortisation from the date of the business combination.”

In preparing its opening Ind AS Balance sheet, an entity applies the criteria in Ind AS 109 to classify financial instruments on the basis of the facts and circumstances that exist at the date of transition to Ind AS. The resulting classifications are applied retrospectively.

For those financial assets and financial liabilities measured at amortised cost in the opening Ind AS balance sheet, an entity determines the cost of the financial assets and the financial liabilities on the basis of circumstances existing when the assets and liabilities first satisfied the recognition criteria in Ind AS 109. **However, if the entity acquired those financial**

assets and financial liabilities in a past business combination, their carrying amount in accordance with previous GAAP immediately following the business combination is their deemed cost in accordance with Ind AS at that date.

In accordance with the above, unless there is a transitional relief under Ind AS 101 for financial instruments, the requirements of Ind AS 109 need to be applied retrospectively. It is pertinent to note that although Ind AS 101 does not provide for any transitional relief for financial instruments and requires applying requirements of Ind AS 109 retrospectively. However, Ind AS 101 specifically provides guidance with regard to treatment to be done if entity elects to opt not to restate past business combinations. Accordingly, if financial instruments have been acquired as part of the business combinations, then requirements of Appendix C to Ind AS 101 shall apply.

In the given case, for the financial instruments acquired as part of the business combination carrying amount as per the previous GAAP shall be their deemed cost at the date of business combination. Fair value or amortised cost (as required by Ind AS 109) shall be determined from the date of business combination and not from the date of origination of such financial instrument by Company B. If financial instruments are classified as FVTPL/FVOCI, then these should be measured at fair value at the date of transition to Ind AS. If these instruments are classified at amortised cost, then the entity determine the carrying amount on the transition date by taking the carrying amount of the loan at the date of business combination under previous GAAP and apply the effective interest rate which is determined after considering the amount and timing of expected settlement of such financial instrument. .

Issue 10: On the date of transition, an entity has elected to measure its assets and liabilities at its deemed cost in accordance with previous GAAP carrying value as permitted under Ind AS 101 *First-time Adoption of Indian Accounting Standards* in the opening Ind AS Financial Statements.

Whether any adjustments arising due to application of other Ind AS is to be made to the previous GAAP carrying amount on the date of transition, if this exemption is availed?

Response: Ind AS 101 defines ‘Deemed Cost’ as an amount used as a surrogate for cost or depreciated cost at a given date. Subsequent depreciation or amortisation assumes that the entity had initially recognised the asset or liability at the given date and that its cost was equal to the deemed cost.”

Further, paragraph 10 of Ind AS 101, provides as follows:

“Except as described in paragraphs 13–19 and Appendices B–D, an entity shall, in its opening Ind AS Balance Sheet:

- (a) recognise all assets and liabilities whose recognition is required by Ind ASs;
- (b) not recognise items as assets or liabilities if Ind ASs do not permit such recognition;

- (c) reclassify items that it recognised in accordance with previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity in accordance with Ind ASs; and
- (d) apply Ind ASs in measuring all recognised assets and liabilities.

In view of the above, except any specific exemption /exception as laid out in Ind AS 101, all the assets and liabilities are required to be recognised in accordance with the principles of Ind AS 101.

There may be certain situations where no exemption /exception has been provided in respect of an item of asset and/or liability; however, application of Ind AS principles has a corresponding impact on another item of asset and/or liability in respect of which Ind AS 101 permits carry forward of previous GAAP amounts as at the transition date. In such situations, since the adjustment to assets /liabilities is only consequential and arising because of application of the transition requirements of Ind AS 101, the previous GAAP carrying amount needs to be adjusted only to this extent. It may be noted that except such situations, no further adjustment should be made due to application of other Ind AS, if an entity measure its assets and liabilities at its deemed cost in accordance with previous GAAP carrying value as permitted under Ind AS 101 on the date of transition. Please also refer Issue No. 4 and Issue No. 5 of ITFG Clarification Bulletin 5 and Issue no. 1 of ITFG Clarification Bulletin 10.

Issue 11: V Ltd. is covered under Phase II of Ind AS roadmap and is required to apply Ind AS from financial year 2017-18. It has given financial guarantee for five years against the loan taken by its associate company, S Ltd. since 1.4.2014 and charging 1% guarantee commission.

(a) At what value will the financial guarantee contract be accounted for in the opening Ind AS balance sheet of V Ltd.

(b) Further, if on 31.3.2016, the guarantee is invoked but V Ltd. has shown it under contingent liability in financial statement of 2015 and also 2016 contesting that it is confident that liability shall not devolve on it.

Whether on transition date i.e. 1.4.2016 the impairment need to be calculated and accordingly fair value of financial guarantee need to be calculated.

Response: (a) Presuming that the financial guarantee given by V Ltd. meets the definition of financial guarantee contracts under Ind AS 109, if the associate company S Ltd. pays the parent company V Ltd. a guarantee commission, company V Ltd. is required to determine if this commission represents the fair value of the financial guarantee contract. If the premium is equivalent to an amount that company S Ltd. would have paid to obtain a similar guarantee in a standalone arm's length transaction, then at the initial recognition the fair value of the financial guarantee contract is likely to equal the commission received.

(b) Paragraph 4.2.1 of Ind AS 109, *Financial Instruments* states as follows:

“4.2.1 An entity shall classify all financial liabilities as subsequently measured at amortised cost, except for:

c) financial guarantee contracts. After initial recognition, an issuer of such a contract shall (unless paragraph 4.2.1(a) or (b) applies) subsequently measure it at the higher of:

(i) the amount of the loss allowance determined in accordance with Section 5.5 and

(ii) the amount initially recognised (see paragraph 5.1.1) less, when appropriate, the cumulative amount of income recognised in accordance with the principles of Ind AS 18”

5.5.1 An entity shall recognise a loss allowance for expected credit losses on a financial asset that is measured in accordance with paragraphs 4.1.2 or 4.1.2A, a lease receivable, a loan commitment and a financial guarantee contract to which the impairment requirements apply in accordance with paragraphs 2.1(g), 4.2.1(c) or 4.2.1(d).

Company V Ltd. should recognise a liability for the amount of premium received and subsequently measure the financial guarantee contract at the higher of the amount of loss allowance determined in accordance with Ind AS 109 and the amount initially recognised less cumulative amount of income recognised in accordance with Ind AS 18, *Revenue*.

In accordance with the above, at the end of each reporting period the entity shall estimate and recognise the expected loss in accordance with the provisions prescribed in the standard.

Accordingly, in the given case V Ltd. shall estimate and recognise the same in accordance with Ind AS 109.
