

Compendium of ITFG Clarification Bulletins

(including clarifications issued till December 2018)



The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi

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Clarifications given or views expressed by the Ind AS Technical Facilitation Group (ITFG) represent the views of the members of the ITFG and are not necessarily the views of the Ind AS Implementation Group or any Committee/Board 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 Bulletin is indicated along with the clarification Bulletin. 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.

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Foreword to the second edition

Majorly all large companies in India will be Ind AS-compliant by the end of the current financial year 2018-19. As implementation of Ind AS began in the country, a number of issues were raised by the members, preparers and other stakeholders with regard to applicability/implementation of Ind AS. For addressing transition related and Ind AS Implementation issues in a timely and speedy manner, Ind AS Technical Facilitation Group (formerly known as, Ind AS Transition Facilitation Group) (ITFG) is working persistently in providing timely clarifications to members and others concerned. For this purpose, the Group issues clarification bulletins addressing implementation issues from time to time. Till date, the Group has brought out clarifications on 132 issues through its 17 clarification bulletins.

This Second Edition of the publication has been updated to include compilation of all the 132 issues clarified till date through all these Clarifications Bulletins.

I sincerely appreciate the determined efforts put in by CA. Nihar Niranjana Jambusaria, Convenor, CA. Dhinal Ashvinbhai Shah, Deputy Convenor and all members of the Ind AS Technical Facilitation Group for their valuable technical contribution and cooperation in bringing out ITFG clarification bulletins in a timely manner. I also congratulate CA. S.B. Zaware, Chairman and CA. M.P. Vijay Kumar, Vice-chairman, Accounting Standards Board of ICAI for their support.

I am confident that this publication would be of great relevance for the members and other stakeholders in implementing Ind AS.

New Delhi
January 2, 2019

CA. Naveen N.D. Gupta
President, ICAI

Preface to the second edition

The implementation of Indian Accounting Standards (Ind AS) converged with International Financial Reporting Standards (IFRS) by Indian Companies is a monumental step in the accounting history of India. ICAI is committed to play an important role to ensure effective and smooth implementation of IFRS converged Ind AS in India. For this purpose, the Ind AS Implementation Group of the ICAI is actively engaged in providing adequate guidance to members on Ind AS through its various initiatives.

One of the initiatives is to provide timely clarification on the transition related and Ind AS Implementation related issues. For this purpose, an Ind AS Transition Facilitation Group (ITFG) was constituted in the year 2016. In the year 2018, the said Group has been renamed as Ind AS Technical Facilitation Group (ITFG). The Group comprises of experts from accountancy firms, industry representatives and other eminent professionals. The group met 18 times in a span of three years to resolve the queries raised and till date have issued 17 clarification bulletins comprising 132 issues. The first edition contained clarifications issued till bulletin 14. This second edition of the publication has been updated to include the clarifications issued through bulletin 15, 16 and 17. Thus, this publication contains all the issues clarified through these 17 ITFG Clarifications Bulletins at one place for ease of reference of the members and other stakeholders.

We may apprise that the clarifications given or views expressed by the Ind AS Technical Facilitation Group (ITFG) represent the views of the members of the ITFG and are not necessarily the views of the Ind AS Implementation Group or any Committee/Board 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 Bulletin is indicated along with the clarification Bulletin. 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.

We would like to convey sincere gratitude to our Honorable President, CA. Naveen N D Gupta and Vice-President, CA. Prafulla Premsukh Chhajed for providing us the opportunity of bringing out this publication. We also appreciate the contributions of all the members of the Ind AS Technical Facilitation Group (ITFG) in bringing out these clarification bulletins.

We also acknowledge the technical contribution made by CA. Geetanshu Bansal, Secretary, Ind AS Implementation Group, CA. Prachi Jain, Executive Officer and CA. Geetu Jain, Project Associate in bringing out all the ITFG Clarification Bulletins and in bringing this publication. I would also like to thank CA. Vidhyadhar Kulkarni, Head, Technical Directorate, ICAI, for his technical support and guidance.

We sincerely believe that this compilation of the ITFG Clarification bulletins would help members and other stakeholders in implementing Ind AS.

CA. Nihar Niranjana Jambusaria
Convenor
Ind AS Technical Facilitation Group

CA. Dhinal Ashvinbhai Shah
Deputy convenor
Ind AS Technical Facilitation Group

Foreword

ICAI is leading the way in embracing accounting standards of excellence and playing a pivotal role to ensure effective and smooth implementation of IFRS converged Ind AS in India. Various initiatives are undertaken for training of our accounting professionals, creating awareness and providing guidance on Ind AS. Transition to Ind AS, a comprehensive set of principle based standards, involves huge efforts. Hence, any transition of this size and nature comes with its own set of challenges. Recognising the challenges at an early stage, ICAI is making every possible effort to take these in stride, such as constitution of Ind AS Implementation Committee, way back in the year 2011.

This Committee, since formation, is actively engaged in providing guidance to the members and other stakeholders so as to enable them to implement these Standards in the same spirit in which these have been formulated. For addressing transition related queries in a timely and speedy manner, an Ind AS Transition Facilitation Group (ITFG) of the Committee is working hard in providing timely clarifications to members and others concerned. For this purpose, the Group issues clarification bulletins addressing implementation issues from time to time. Till date, the Group has brought out clarifications on 104 issues through its 14 clarification bulletins. For ease of reference of members it has been considered appropriate that a publication containing compilation of all the 104 issues clarified till date through these 14 ITFG Clarifications Bulletins be brought out along with its standard-wise indexation.

I convey my heartfelt thanks to CA. Dhinal Ashvinbhai Shah, Chairman, CA. Sanjay Vasudeva, Vice- Chairman, and all members of the Ind AS Transition Facilitation Group (ITFG) of Ind AS Implementation Committee for their tremendous contribution in bringing out these clarification bulletins.

I am confident that this publication would be of great relevance for the members and other stakeholders in implementing Ind AS.

New Delhi
February 2, 2018

CA. Nilesh S. Vikamsey
President, ICAI

Preface

In order to enable the nation with robust high quality globally acceptable accounting standards, ICAI spearheaded the implementation of IFRS-converged Indian Accounting Standards (Ind AS). Application of these standards requires high level of professional competence and skill sets. ICAI recognised this challenge at an early stage and has taken a number of steps to satisfactorily address this challenge and ensure smooth trouble free transition to new accounting standard framework. ICAI efforts have yielded the positive result and Ind AS has become a reality now as the era of Implementation of Ind AS has already begun in the country with Phase I companies who have published their financial statements prepared in accordance with Ind AS for financial year 2016-17. Phase II companies have published their half yearly results prepared in accordance with Ind AS.

ICAI is leading the way in embracing accounting standards of excellence and is committed to play an important role to ensure effective and smooth implementation of IFRS converged Ind AS in India. For this purpose, the Ind AS Implementation Committee of the ICAI is actively engaged in providing adequate guidance to members on Ind AS through its various initiatives. As the implementation of Ind AS began in the country, a number of issues were being raised by the members, preparers and other stakeholders with regard to applicability/implementation of Ind AS. In order to provide timely clarification on the issues raised, an Ind AS Transition Facilitation Group (ITFG) was constituted under the aegis of this Committee in the year 2016. The Group comprised of experts from accountancy firms, industry representatives and other eminent professionals. The group met 14 times in a span of two years to resolve the queries raised and till date have issued 14 clarification bulletins comprising 104 issues.

The purpose of this publication is to bring all the issues clarified through these 14 ITFG Clarifications Bulletins at one place for ease of reference of the members and other stakeholders.

I may apprise that the 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 Bulletin is indicated

along with the clarification Bulletin. 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.

I would like to convey sincere gratitude to our Honorable President, CA. Nilesh S. Vikamsey and Vice-President, CA. Naveen N D Gupta for providing us the opportunity of bringing out this publication. I am also thankful to CA. Sanjay Vasudeva, Vice-Chairman, Ind AS Implementation Committee for his efforts in all the endeavours of the Committee. I am extremely thankful to all the members of the Ind AS Transition Facilitation Group (ITFG) for their valuable contribution in bring out these clarification bulletins in a short span of time.

I deeply appreciate the technical contribution made by CA. Geetanshu Bansal, Secretary, Ind AS Implementation Committee and CA. Prachi Jain, Executive Officer in bringing out all the ITFG Clarification Bulletins. I also acknowledge CA. Geetu Jain, Project Associate and CA. Vaishali Jaggi, Project Associate in helping out in bringing this publication. I would also like to thank CA. Vidhyadhar Kulkarni, Head, Technical Directorate, ICAI, for his technical support and guidance.

I sincerely believe that this compilation of all the ITFG Clarification bulletins would help members and other stakeholders in implementing Ind AS.

New Delhi
February 2, 2018

CA. Dhinal Ashvinbhai Shah
Chairman,
Ind AS Implementation Committee

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Applicability related Issues: Roadmap

Applicability of Ind AS- Subsidiaries of Listed Company (different scenario)

Issue 1: Company A is a listed company and has three Subsidiaries Company X, Company Y and Company Z. As on 31st March 2014, the net worth of Company A is ` 600 Crores, net worth of Company X is ` 100 Crores, Company Y is ` 400 Crores and Company Z is ` 210 Crores. All the three subsidiaries are non-listed public companies.

Case A During the financial year 2014-15, Company A has sold off its entire investment in Company X on 31st December 2014. Therefore, Company X is no longer a subsidiary of Company A for the purposes of preparation of financial statements as on 31st March 2015. Should Company X prepare its financial statements as per the Companies (Accounting Standards) Rules, 2006 or the Companies (Indian Accounting Standards) Rules, 2015?

Case B During the financial year 2015-16, Company A has sold off its investment in Company Y on 31st December, 2015. Therefore, Company Y is no longer a subsidiary of Company A for the purposes of preparation of financial statements as on 31 March 2016. Should Company Y prepare its financial statements as per the Companies (Accounting Standards) Rules, 2006 or the Companies (Indian Accounting Standards) Rules, 2015?

Case C During the financial year 2016-17, Company A has sold off its investment in Company Z on 31st December 2016, therefore company Z is no longer a subsidiary of Company A for the purposes of preparation of financial statements as on 31 March 2017. Should Company Z prepare its financial statements as per the Companies (Accounting Standards) Rules, 2006 or the Companies (Indian Accounting Standards) Rules, 2015?

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

(4) (1) The Companies and their auditors shall comply with the Indian Accounting Standards (Ind AS) specified in Annexure to these rules in preparation of their financial statements and audit respectively, in the following manner, namely:-

(ii) the following companies shall comply with the Indian Accounting Standards (Ind AS) for the accounting periods beginning on or after

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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;*

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).

Rule (9) of the Companies (Indian Accounting Standards) Rules, 2015, states that:

“Once a company starts following the Indian Accounting Standards (Ind AS) either voluntarily or mandatorily on the basis of criteria specified in sub-rule (1), it shall be required to follow the Indian Accounting Standards (Ind AS) for all the subsequent financial statements even if any of the criteria specified in this rule does not subsequently apply to it”.

In view of the above requirements, Company A meets the criteria as specified in the Rule 4(2) (a) of the Companies (Indian Accounting Standards) Rules, 2015, on 31st March, 2014. Accordingly, the Companies (Indian Accounting Standards) Rules, 2015, will become applicable to the Company on mandatory basis from accounting periods commencing 1st April, 2016.

As per the Rule 4(1)(ii)(c) of the Companies (Indian Accounting Standards) Rules, 2015, a holding, subsidiary, joint venture or associate company of a Company to which the Companies (Indian Accounting Standards) Rules, 2015 applies will be required to follow the Companies (Indian Accounting Standards) Rules, 2015 for preparing and presenting its financial statements.

In the abovementioned case, Company A has net worth of more than ₹ 500 crore in the financial year ending 31 March 2014. Therefore, ordinarily Company A along with its subsidiaries will have to apply Indian Accounting Standards (Ind ASs) for preparing financial statements for the accounting periods commencing 1st April, 2016, except in situations covered by Case A and Case B as discussed below.

Case A

Company A has sold off its entire investment in Company X on 31st December, 2014; Company X is no longer a subsidiary of Company A as at the beginning of 1st April, 2016. Therefore, in this case, Company X would continue to prepare financial statements for the accounting periods commencing 1st April, 2016, as per the Companies (Accounting Standards) Rules, 2006.

Case B

Company A has sold its investment in subsidiary Company Y on 31st December, 2015, in consequence of which Company Y is no longer subsidiary of Company A as at the beginning of 1st April, 2016. Therefore, the Companies (Indian Accounting Standards) Rules, 2015 will not be applicable to Company Y. Therefore, Company Y would continue to prepare financial statements for accounting periods commencing April 1, 2016 under the Companies (Accounting Standards) Rules, 2006.

Case C

In the given case, Company A has sold its investment in subsidiary Company Z on 31st December, 2016; therefore, Company Z was a subsidiary of Company A as at the beginning of 1st April, 2016. Company Z being

subsidiary of Company A as at the beginning of 1st April, 2016, would have to prepare financial statements for the accounting periods commencing 1st April, 2016 as per the Companies (Indian Accounting Standards) Rules, 2015.

(ITFG Clarification Bulletin 1, Issue 2)
(Date of finalisation: January 16, 2016)

Applicability of Ind AS to NBFCs in case not registered with RBI

Issue 2: A Company ABC Ltd. performs role of NBFC and has applied for the registration as NBFC which is awaited from the Reserve Bank of India (RBI).

Whether roadmap for the applicability of Ind AS as applicable to NBFCs also applies to the Company ABC Ltd., which performs role of NBFC however, it is not registered with the RBI?

Response: Rule 4(1)(iii) of the Companies (Indian Accounting Standards) (Amendments) Rules, 2016 lays down the roadmap for the applicability of Ind AS to NBFCs. As per the said rules, “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, Chit Companies, Securitisation and Reconstruction Companies, Mortgage Guarantee Companies, Pension Fund Companies, Asset Management Companies and Core Investment Companies.*

In view of the above, it is pertinent to note that the above definition covers a company which is carrying on the activity of Non-Banking Financial Company. The definition of NBFC is given under the RBI Act, 1934. Hence the company which is carrying on the activity of NBFC but not registered with RBI will also be subject to the roadmap for the applicability of Ind AS as applicable to any other NBFC. However, the requirements with regard to registration, eligibility of a company to operate as NBFC (pending registration) etc. are governed by the Reserve Bank of India Act, 1934 and Rules laid down thereon and should be evaluated by the entity based on its own facts and circumstances separately.

(ITFG Clarification Bulletin 13, Issue 4)
(Date of finalisation: January 16, 2018)

Applicability of Ind AS to India branch office of foreign company

Issue 3: 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.

(ITFG Clarification Bulletin 12, Issue 6)

(Date of finalisation: October 23, 2017)

Applicability of Ind AS to non-corporate entities

Issue 4: A Ltd. is a first-time adopter of Ind AS. It had incorporated a partnership firm with B Ltd. namely, M/s A&B Associates. Whether Ind AS will be applicable to M/s A & B Associates by virtue of the fact that Ind AS is applicable to A Ltd?

Also clarify, whether Ind AS will be applicable to non-corporate entities?

Response: The applicability of Ind AS has been specified for classes of companies specified in Rule 4 of Companies (Indian Accounting Standards) Rules, 2015. Indian Accounting Standards notified under the Companies (Indian Accounting Standards) Rules, 2015, are applicable for the corporates only. Non- corporates are required to follow the accounting standards issued by the Institute of Chartered Accountants of India. They cannot be applied by non-corporate entities even voluntarily.

However, in case, a relevant regulator specifically provides for implementation of Ind AS, the non-corporate entities shall apply Ind AS, for example, SEBI has mandated implementation of Ind AS for Infrastructure Investment Trusts (InvITs) and Real Estate Investment Trusts (REITs). Similarly, if Central Government notifies certain body corporate under clause (1)(4)(f) of Companies Act, 2013, such entities will be required to apply Ind AS. For other non-company entities, Accounting Standards issued by the ICAI shall be applicable and there will be no option to follow Ind AS to such entities.

Accordingly, in the given case, Ind AS is not applicable to partnership firms. However, for the purpose of consolidation, the partnership firm will be required to provide financial statements data prepared as per Ind AS to A Ltd provided the partnership qualifies as a subsidiary/joint venture/associate of A Ltd.

(ITFG Clarification Bulletin 11, Issue 7)

(Date of finalisation: July 31, 2017)

Applicability of Ind AS to holding company (NBFC) of the subsidiary which is covered under the criteria of Ind AS roadmap

Issue 5: Company X is falling under Phase II of MCA roadmap for companies and hence Ind AS are applicable to it from the financial year 2017-18. Company X is a subsidiary of Company Y. Company Y is an unlisted NBFC company having net worth of ` 285 crores. What will be the date of applicability of Ind AS for company X and company Y? If Ind AS applicability date for parent NBFC is different from the applicability date of corporate subsidiary, then, how will the consolidated financial statements of parent NBFC be prepared?

Response: Rule 4(1)(iv)(b) of Companies (Indian Accounting Standards)

Rules, 2015 read with Companies (Indian Accounting Standards) (Amendment) Rules, 2016 states as under:

“

(b) The following NBFCs shall comply with the Indian Accounting Standards (Ind AS) for accounting periods beginning on or after the 1st April, 2019, with comparatives for the periods ending on 31st March, 2019, or thereafter-

(A) NBFCs whose equity or debt securities are listed or in the process of listing on any stock exchanges in India or outside India and having net worth less than rupees five hundred crore;

(B) NBFCs, that are unlisted companies, having net worth of rupees two-hundred and fifty crore or more but less than rupees five hundred crore; and

(C) holding, subsidiary, joint venture or associate companies of companies covered under item (A) or item (B) of sub-clause (b), other than those already covered in clauses (i), (ii) and (iii) of sub-rule (1) or item (B) of sub-clause (a) of clause (iv).”

In accordance with the above, it may be noted that NBFCs having net worth of less than 500 crore shall apply Ind AS from 1.4.2019 onwards. Further, the holding, subsidiary, joint venture or associate company of such an NBFC other than those covered by corporate roadmap shall also apply Ind AS from 1.4.2019.

Further, explanation to clause (iv), states as under:

“Explanation. – For the purposes of clause (iv), if in a group of Companies, some entities apply Accounting Standards specified in the Annexure to the Companies (Accounting Standards) Rules, 2006 and others apply accounting standards as specified in the Annexure to these rules, in such cases, for the purpose of individual financial statements, the entities should apply respective standards applicable to them. For preparation of consolidated financial statements, the following conditions are to be followed, namely:-

(i) where an NBFC is a parent (at ultimate level or at intermediate level), and prepares consolidated financial statements as per Accounting Standards specified in the Annexure to the Companies (Accounting Standards) Rules, 2006, and its subsidiaries, associates and joint ventures, if covered by clause (i), (ii) and (iii) of sub-rule (1) has to provide the relevant financial statement data

in accordance with the accounting policies followed by the parent company for consolidation purposes (until the NBFC is covered under clause (iv) of sub-rule (1);

- (ii) *where a parent is a company covered under clause (i), (ii) and (iii) of sub-rule (1) and has an NBFC subsidiary, associate or a joint venture, the parent has to prepare Ind AS- compliant consolidated financial statements and the NBFC subsidiary, associate or a joint venture has to provide the relevant financial statement data in accordance with the accounting policies followed by the parent company for consolidation purposes (until the NBFC is covered under clause (iv) of sub-rule (1)).”*

Accordingly, in the given case, Company Y (NBFC) shall apply Ind AS from 1.4.2019. Company X shall apply Ind AS in its individual financial statements from financial year 2017-18 (as per the corporate roadmap) and for the financial year 2017-18 and 2018-19, Company X shall also prepare its individual financial statements as per the Companies (Accounting Standards) Rules, 2006 to facilitate the preparation of consolidated financial statement by parent Company Y (NBFC).

(ITFG Clarification Bulletin 6, Issue 3)

(Date of finalisation: November 19, 2016)

Applicability of Ind AS - Section 8 Company

Issue 6: Company X Ltd. is being covered under Phase I of Ind AS and needs to apply Ind AS from financial year 2016-17. Company Y which is an associate company of Company X Ltd. is a charitable organisation and registered under section 8 of the Companies Act, 2013.

Whether Company Y is required to comply with Ind AS from financial year 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 the thresholds specified in Rule 4(1)(ii) are required to comply with Ind AS from financial year 2016-17.

Further, it may be noted that the companies covered under Section 8 are required to comply the provisions of the Companies Act, 2013, unless and until any exemption is provided. Section 8 companies are not exempted from the requirements of section 133 and section 129 of the Companies Act, 2013.

In view of the above, in the given case, Company Y will be required to apply Ind AS from financial year 2016-17.

*(ITFG Clarification Bulletin 6, Issue 2)
(Date of finalisation: November 19, 2016)*

Applicability of Ind AS- Date of Transition

Issue 7: A company covered under Phase I, having net worth of ` 600 crores, decides to give comparatives for F.Y. 2015-16 and F.Y. 2014-15. What should be date of transition in this case?

Response: Appendix A to Ind AS 101, *First- time Adoption of Indian Accounting Standards*, defines date of transition as follows:

“The beginning of the earliest period for which an entity presents full comparative information under Ind ASs in first Ind AS financial statements”

The definition of the date of transition as stated above therefore permits an entity to select its date of transition. However, Rule 4(1)(i) and (ii) of the Companies (Indian Accounting Standards) Rules, 2015, state as under:

“The Companies and their auditors shall comply with the Indian Accounting Standards (Ind AS) specified in Annexure to these rules in preparation of their financial statements and audit respectively, in the following manner, namely:-

- (i) *any 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;*
- (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...”.*

In the given case, the Company is required to mandatorily adopt Ind AS from April 1, 2016, i.e., for the period 2016-17, and with comparatives as per Ind AS for 2015-16. Accordingly, the beginning of the comparative period will be April 1, 2015, which will be considered as the date of transition as per Ind AS. Therefore, the date of transition to Ind AS shall be April 1, 2015. The company cannot have the date of transition at April 1, 2014.

(ITFG Clarification Bulletin 4, Issue 4)

(Date of finalisation: August 19, 2016)

Applicability of Ind AS - change in status of listed company

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 sub clause (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.

(ITFG Clarification Bulletin 3, Issue 8)

(Date of finalisation: June 22, 2016)

Applicability of Ind AS to holding company when subsidiary meets the criteria for applicability of Ind AS

Issue 9: Company X (Listed entity) has a net worth of above ` 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 ` 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 ` 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.

*(ITFG Clarification Bulletin 3, Issue 7)
(Date of finalisation: June 22, 2016)*

Applicability of Ind AS - associate company In case of quarterly results

Issue 10: Company X, on a standalone basis, has a net worth of above ₹ 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 ₹ 250 crore but below ₹ 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;*

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 ` 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.

(ITFG Clarification Bulletin 3, Issue 6)

(Date of finalisation: June 22, 2016)

Applicability of Ind AS to Core Investment Company (CIC)

Issue 11: 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.

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.

(ITFG Clarification Bulletin 3, Issue 2)

(Date of finalisation: June 22, 2016)

Date of Transition in case a company is already preparing financials as per IFRS

Issue 12: Company X Ltd. has prepared its financial statements under IFRS for the first time for year ended March 31, 2016. It had adopted its date of transition to IFRS as April 1, 2014. As per the Companies (Indian Accounting Standards) Rules, 2015, Company X Ltd. is mandatorily required to prepare its financial statements as per Ind AS for the year ended March 31, 2017 and hence under Ind AS, the date of transition would be April 1, 2015.

Whether Company X Ltd. can select date of transition under Ind AS as April 1, 2014 instead of April 1, 2015 since it has already carried out exercise of transition on April 1, 2014 for the purposes of IFRS.

Response: Appendix A to Ind AS 101, *First-time Adoption of Indian Accounting Standards*, defines date of transition as follows:

“The beginning of the earliest period for which an entity presents full comparative information under Ind ASs in first Ind AS financial statements”

The definition of date of transition as stated above therefore permits an entity to select its date of transition. However, Rule 4(1) (i) and (ii) of the Companies (Indian Accounting Standards) Rules, 2015, states as under:

“The Companies and their auditors shall comply with the Indian Accounting Standards (Ind AS) specified in Annexure to these rules in preparation of their financial statements and audit respectively, in the following manner, namely:-

- (i) any 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;

- (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...”.*

As per the above rule, the date of transition for X Ltd. will be April 1, 2015 being the beginning of the earliest comparative period presented. To explain it further, X Ltd. is required to mandatorily adopt Ind AS from April 1, 2016, i.e. for the period 2016-17, and it will give comparatives as per Ind AS for 2015-16. Accordingly, the beginning of the comparative period will be April 1, 2015 which will be considered as the date of transition as per Ind AS.

Although Company X Ltd. has already carried out exercise of transition on April 1, 2014 for the purposes of IFRS, Company X Ltd. cannot select date of transition under Ind AS as April 1, 2014.

(ITFG Clarification Bulletin 2, Issue 3)

(Date of finalisation: April 12, 2016)

Applicability of Ind AS to an Indian subsidiary of a foreign company

Issue 13: Company X Ltd. and Company Y Ltd. registered in India having net worth of ` 600 crores and 100 crores respectively are subsidiaries of a Foreign Company viz., ABC Inc., which has net worth of more than ` 500 crores in financial year 2015-16. Whether Company X Ltd. and Y Ltd. are required to comply with Ind AS from financial year 2016-17 on the basis of net worth of the parent Foreign Company or on the basis of their own net worth?

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

“The Companies and their auditors shall comply with the Indian Accounting Standards (Ind AS) specified in Annexure to these rules in preparation of their financial statements and audit respectively, in the following manner, namely:-

- (i) *any 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;*

(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;"*

As per Rule 4(1)(ii)(a) of the Companies (Indian Accounting Standards) Rules, 2015, Company X having net worth of ` 600 crores in the year 2015-16, would be required to prepare its financial statements for the accounting periods commencing from 1st April, 2016, as per the Companies (Indian Accounting Standards) Rules, 2015.

Company Y Ltd. having net worth of ` 100 crores in the year 2015-16, would be required to prepare its financial statements as per the Companies (Accounting Standards) Rules, 2006.

Since, the Foreign company ABC Inc., is not a company incorporated under the Companies Act, 2013 or the earlier Companies Act, 1956, it is not required to prepare its financial statements as per the Companies (Indian Accounting Standards) Rules, 2015. As the foreign company is not required to prepare financial statements based on Ind AS, the net worth of foreign company ABC would not be the basis for deciding whether Indian Subsidiary Company X Ltd. and Company Y Ltd. are required to prepare financial statements based on Ind AS.

*(ITFG Clarification Bulletin 2, Issue 2)
(Date of finalisation: April 12, 2016)*

Applicability of Ind AS - associate company Consideration of share warrants which are convertible into equity shares

Issue 14: 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 does 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 (e.g. 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 (e.g. 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 (i.e. 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 the 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.

*(ITFG Clarification Bulletin 3, Issue 5)
(Date of finalisation: June 22, 2016)*

Applicability of Ind AS to holding, subsidiary, joint venture and associate company through direct or indirect association in case of voluntary adoption by the parent company

Issue 15: 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 (e.g. 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 (e.g. 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.

(ITFG Clarification Bulletin 3, Issue 4)

(Date of finalisation: June 22, 2016)

Applicability of Ind AS to holding company, if subsidiary company incorporated for divestment purpose complies with Ind AS

Issue 16: ABC Ltd. is a listed company. The net worth of ABC Ltd. as on 31st March, 2014 was ` 200 crores.

ABC Ltd. had a subsidiary, namely, XYZ Ltd. as at 31st March, 2015 whose net worth, consisting only of share capital as at that date, was ` 600 crores. XYZ Ltd. was incorporated in January, 2015. It was incorporated only for the purposes of its divestment. The financial statements of XYZ Ltd. were not consolidated with that of ABC Ltd. as at 31st March, 2015 in view of requirements of paragraph 11 of Accounting Standard (AS) 21, *Consolidated Financial Statements*.

ABC Ltd. entered into agreement with a proposed acquirer of the subsidiary, i.e., PQR Ltd., in September, 2015. The entire ownership of XYZ Ltd. was finally transferred to the said acquirer in the first fortnight of April, 2016.

In the given case, whether the ABC Ltd. is required to comply with Ind AS from the financial year 2016-17?

Response: Rule 4(1)(ii) of the 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.

Further, Rule 4(2) (b) 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:-

.....

(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).

Illustration - (i) The companies meeting threshold for the first time as on 31st March, 2017 shall apply Ind AS for the financial year 2017-18 onwards.

(ii) The companies meeting threshold for the first time as on 31st March, 2018 shall apply Ind AS for the financial year 2018-19 onwards and so on."

On a combined reading of Rule 4(1) and (2) of the Companies (Indian Accounting Standards) Rules, 2015, if an existing company meets the net worth criteria before mandatory applicability dates laid down in the roadmap, the company would be required to follow Ind AS as per the dates for implementation of Ind AS prescribed in the roadmap, i.e., 2016-17 or 2017-18, as the case may be.

In the given case, Ind AS will be mandatorily applicable to XYZ Ltd. from financial year, 2016-17, since its net worth as on 31st March, 2015 is more than ` 500 crores.

As already clarified in ITFG Clarification Bulletin 3 as Issue No. 5, consistent approach would be followed 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. Therefore, the relationship between ABC Ltd. and XYZ Ltd. should be determined in accordance with Indian Accounting Standards (Ind AS). Hence, it is irrelevant to consider the fact that XYZ Ltd. was not a subsidiary company of ABC Ltd. as per the previous GAAP.

In view of the above ITFG clarification, whether ABC Ltd. is a holding company of XYZ Ltd. or not shall be determined as per Ind AS 110, *Consolidated Financial Statements*, i.e., evaluating whether ABC Ltd. controls XYZ Ltd. or not.

If ABC Ltd. was a holding company of XYZ Ltd. in accordance with Ind AS 110 as at 31st March, 2015, then ABC Ltd. should comply with Ind AS from the financial year 2016-17, since Ind AS are applicable to XYZ Ltd. from financial year 2016-17.

(ITFG Clarification Bulletin 5, Issue 1)

(Date of finalisation: September 19, 2016)

Applicability of Ind AS in case of change in the status of listed company or company in the process of listing or listed debentures issued during the year

Issue 17: XYZ Limited is a company having net worth less than INR 250 crores as on 31 March 2017. What is the status of applicability of Ind AS for the company in the following scenarios:

- (a) the company was in the process of listing as at the beginning of the year (i.e. 1st April 2017) and the company ultimately gets listed as at the end of the year (March 2018);
- (b) the company is listed at the beginning of the year and during the year it gets de-listed;
- (c) the process of listing began during the year, for e.g. in the month of May 2017 and the company ultimately gets listed as at the end of the year i.e. March 2018. Will there be any difference if the company gets listed in April, 2018. i.e. it was in process of listing as at the year end.
- (d) the company issued listed debentures in the month of May 2017. However, in the month of January 2018, the debentures got de-listed.

Response: Rule 4 (1) of the Companies (Indian Accounting Standards) Rules, 2015 read with Companies (Indian Accounting Standards) (Amendment) Rules, 2016 *inter-alia* states as follows:

“(i)...

(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 subrule (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*
- (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 sub-clause (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.”*
- (a) In the given case, since the company began the process of listing as at the beginning of the year but had net worth less than INR 250 crores, it shall be required to comply with Ind AS from the financial year 2017-18. Accordingly, XYZ Limited shall prepare Ind AS financial statements for the financial year 2017-18.
- (b) In the given case, since the company is listed at the beginning of the year it shall be required to comply with Ind AS from the same year irrespective of the fact that the company gets de-listed as at the end of the year. Accordingly, XYZ Limited shall prepare Ind AS financial statements for the financial year 2017-18.
- (c) In the given case, although the company was neither listed as at the beginning of the period nor it began the process of listing as at the beginning of the year, but it began the process of listing during the year and ultimately got listed as at the end of the year then it shall be required to comply with Ind AS from the same year in

which it began the process of listing. Furthermore, in case the company gets listed during the year say from November 2017, then it will be required to provide Ind AS financial statements for the quarter ending December 2017 and consequently for the year ending March 2018.

Moreover, in the given fact pattern, if the company was in the process as at the year-end, then also it will be required to comply with Ind AS and provide financial statements as per Ind AS for the year ending March 2018.

- (d) In the given case, as at the beginning of the reporting period, the company was not listed. However, it issued listed debentures during the year, i.e., in the month of May 2017 which got de-listed in the month of January 2018. Accordingly, the company has neither the status of a listed entity/or in the process of listing at the beginning of the year as well nor at the end of the year. Hence, it will not be required to comply with Ind AS.

(ITFG Clarification Bulletin 15, Issue 4)

(Date of finalisation: April 04, 2018)

Applicability of Ind AS to NBFC - in case of termination of membership in process

Issue 18: The Company is a registered stock-broker recognised by the Securities and Exchange Board of India (SEBI). The net worth of the Company as on 31st March 2015 is INR 500 crores. As per the Ind AS Rules, it falls under the definition of NBFC roadmap and accordingly, is required to apply Ind AS from 1st April 2018 onwards.

In the month of July 2016, the company applied for terminating its membership to the exchange. It was awaiting clearance from SEBI as of June 2017. It received clearance from the Board in the month of August 2017 accepting their termination. The company also have debt listed securities.

Whether the company should have prepared Ind AS financial statements as a Phase 1 non-NBFC corporate entity as of 31 March 2017 given it has applied for termination of membership with the exchange in the month of July 2016?

Response: Companies (Indian Accounting Standards) (Amendments) Rules, 2016, defines NBFC as follows:

“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, Chit Companies, Securitisation and Reconstruction Companies, Mortgage Guarantee Companies, Pension Fund Companies, Asset Management Companies and Core Investment Companies.”

Further Rule 4(1) (iv) of the said rules lays down the roadmap for applicability of Ind AS as follows:

“Notwithstanding the requirement of clause (i) to (iii), Non-Banking Financial Companies (NBFCs) shall comply with the Indian Accounting Standards (Ind AS) in preparation of their financial statements and audit respectively, in the following manner, namely :-

(a) The following NBFCs shall comply with the Indian Accounting Standards (Ind AS) for accounting periods beginning on or after the 1st April, 2018, with comparatives for the periods ending on 31st March, 2018, or thereafter-

(A) NBFCs having net worth of rupees five hundred crores or more;

(B) holding, subsidiary, joint venture or associate companies of companies covered under item (A), other than those already covered under clauses (i), (ii) and (iii) of sub-rule (1) of rule 4.

(b) The following NBFCs shall comply with the Indian Accounting Standards (Ind AS) for accounting periods beginning on or after the 1st April, 2019, with comparatives for the periods ending on 31st March, 2019, or thereafter-

(A) NBFCs whose equity or debt securities are listed or in the process of listing on any stock exchanges in India or outside India and having net worth less than rupees five hundred crore;

(B) NBFCs, that are unlisted companies, having net worth of rupees two-hundred and fifty crore or more but less than rupees five hundred crore; and

(C) holding, subsidiary, joint venture or associate companies of companies covered under item (A) or item (B) of sub-clause (b), other than those already covered in clauses (i), (ii) and (iii) of sub-rule (1) or item (B) of sub-clause (a) of clause (iv).”

In the given case, the company being a stock-broker was falling under the definition of NBFC as per the above rules and hence as per its net worth was required to comply with Ind AS from 1st April, 2018 onwards.

However, in the given case, in July 2016 the company had applied for termination of its membership as a stock-broker. Accordingly, it needs to be evaluated that whether the company is carrying on the activities of an NBFC or not.

It is also pertinent to note the following clarification issued by ITFG Clarification Bulletin 13 (Issue 4):

*In view of the above, it is pertinent to note that the above definition covers a company which is carrying on the activity of Non-Banking Financial Company. The definition of NBFC is given under the RBI Act, 1934. Hence **the company which is carrying on the activity of NBFC but not registered with RBI will also be subject to the roadmap for the applicability of Ind AS as applicable to any other NBFC.** However, the requirements with regard to registration, eligibility of a company to operate as NBFC (pending registration) etc. are governed by the Reserve Bank of India Act, 1934 and Rules laid down thereon and should be evaluated by the entity based on its own facts and circumstances separately.*

In accordance with the above, if the company was carrying on the activities of an NBFC during the period it was awaiting approval from RBI, then it shall be required to comply with Ind AS as per the roadmap applicable to NBFC. However, if it ceases to carry on the activities of NBFC then the roadmap as applicable to non- NBFC companies should have been followed based on its net worth.

In the given case, assuming that the company was not carrying on the activities of NBFC from July 16 onwards as it has applied for termination of its membership in July 2016, then as per its net worth it should have complied with Ind AS from July 2016 onwards.

*(ITFG Clarification Bulletin 15, Issue 5)
(Date of finalisation: April 04, 2018)*

Applicability of Ind AS – in case of Investor Company and another fellow subsidiary of a holding company

Issue 19: Company B is a listed entity covered in phase II of Ind AS roadmap. Company A is an unlisted entity having net worth less than INR 250 crores and holding Company of Company B. Company D is an unlisted entity and holds 25% in company B (i.e, Company D is an investor company of Company B) and has net worth less than INR 250 crores. Company C is a fellow subsidiary of company B i.e. subsidiary of the holding company A. Whether Ind AS is applicable to Company C and Company D?

Response: As per the roadmap for applicability of Ind AS, holding, subsidiary, joint venture or associate companies of companies which meet the specified criteria are required to comply with the Indian Accounting Standards (Ind AS).

In the given case, since Company B meets the criteria for Ind AS adoption, its holding company would also be required to adopt Ind AS from the same date. Accordingly, Ind AS will be applicable to Company A by virtue of Ind AS being applicable to its subsidiary i.e. Company B in the given case.

With regard to Ind AS applicability for company C, it may be noted that Ind AS applies to holding, subsidiary, joint venture and associate companies of the companies which meet the net worth/listing criteria. This requirement does not extend to another fellow subsidiary of a holding company which is required to adopt Ind AS because of its holding company relationship with a subsidiary meeting the net worth/listing criteria. Holding company will be required to prepare separate and consolidated financial statements mandatorily under Ind AS, if one of its subsidiaries meets the specified criteria and therefore, such subsidiaries may be required by the holding company to furnish financial statements as per Ind AS for the purpose of preparing Holding company's consolidated Ind AS financial statements. Such fellow subsidiaries may, however, voluntarily opt to prepare their financial statements as per Ind AS.

Hence, in the given case, Company C is not mandatorily required to adopt Ind AS for its statutory reporting. Further, company C may apply Ind AS voluntarily for its statutory reporting.

With regard to Ind AS applicability for Company D, it may be noted that Company D is just an investor company and does not qualify as a holding company of Company B. Company D is not required to comply with Ind AS

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by virtue of Company B falling under the threshold of Ind AS applicability (unless it otherwise falls under the road map for applicability of Ind AS, as a consequence of other conditions specified therein). Furthermore, for consolidation purposes, Company B will be required to provide financial statement data prepared in accordance with Companies (Accounting Standards) Rules, 2006 for the purpose of preparation of consolidated financial statements of Company D as per these rules.

(ITFG Clarification Bulletin 15, Issue 10)

(Date of finalisation: April 04, 2018)

Net Worth Criteria

Applicability of Ind AS - Net worth Criteria Treatment of ESOP Reserve

Issue 20: Whether ESOP reserve is required to be included while computing net worth of a company to assess applicability of Ind AS on the company?

Response: As per Rule 2(1) (f) of Companies (Indian Accounting Standards) Rules, 2015, “net worth” shall have the meaning assigned to it as in clause (57) of section 2 of the Act.

Further, as per Section 2(57) of the Companies Act, 2013, “*net worth means the aggregate value of the paid-up share capital and all reserves created out of the profits and securities premium account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation.*”

It may be noted that the Guidance Note on Accounting for Employee Share-based Payments, *inter alia*, provides that *an enterprise should recognise as an expense (except where service received qualifies to be included as a part of the cost of an asset) the services received in an equity-settled employee share-based payment plan when it receives the services, with a corresponding credit to an appropriate equity account, say, ‘Stock Options Outstanding Account’. This account is transitional in nature as it gets ultimately transferred to another equity account such as share capital, securities premium account and/or general reserve as recommended in the subsequent paragraphs of this Guidance Note.*

In accordance with the above, ESOP reserve is required to be included while calculating the net worth of a company.

However, this clarification is only for the purpose of Ind AS applicability and should not be applied by analogy for determining net worth under other provisions of the Companies Act, 2013.

(ITFG Clarification Bulletin 11, Issue 1)
(Date of finalisation: July 31, 2017)

Computation of net worth for Ind AS applicability- Government Grant to be considered as capital reserve

Issue 21: A company received grant from government which is in the nature of promoter's contribution and the same was included in capital reserve. This grant has been accounted as per AS 12, *Accounting for Government Grants*. Is such capital reserve required to be included for computation of net worth to assess Ind AS applicability?

Response: As per Rule 2(1) (f) of Companies (Indian Accounting Standards) Rules, 2015 "net worth" shall have the meaning assigned to it in clause (57) of section 2 of the Act. Section 2(57) of Companies Act, 2013, defines 'net worth' as follows:

"net worth" means the aggregate value of the paid-up share capital and all reserves created out of the profits and securities premium account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation;

From the definition of Section 2(57), it may be noted that all reserves created out of the profits are included in calculation of 'net worth'.

In the given case, the capital reserve has arisen pursuant to grant received from government, which is in the nature of promoter's contribution. On a literal interpretation of the definition, it may be concluded that capital reserve in the nature of promoter's contribution should not be included to calculate net worth as the same is not explicitly mentioned in the definition of net worth. However, in substance, the capital reserve in the nature of promoter's contribution is a capital contribution by promoters and should be included in the calculation of net worth. Further, Accounting Standard (AS) 12 also states that government grants in the nature of promoter's contribution are recognised in shareholders' funds. Therefore, such a capital reserve should be included for computation of 'net worth'.

However, it may be noted that capital reserve in the nature of promoter's contribution should be included in the net worth only for the purpose of Ind AS applicability. This definition should not be applied by analogy for determining net worth under other provisions of the Companies Act, 2013.

*(ITFG Clarification Bulletin 6, Issue 4)
(Date of finalisation: November 29, 2016)*

Applicability of Ind AS - Net worth criteria

Issue 22: A debt-listed company has net worth for the last 3 years as follows:

- (i) Net worth as on 31.03.2014 is ` 1260.83 crores
- (ii) Net worth as on 31.03.2015 is ` 1411.43 crores
- (iii) Net worth as on 31.03.2016 is ` 485.22 crores

Whether Company A is required to comply with Ind AS from financial year 2017-18?

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”.*

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 the net worth shall be calculated in accordance with the stand-alone financial statements of the company as on 31st March, 2014. Accordingly, if the net worth threshold criteria for a company are once met, then it shall be required to comply with Ind AS, irrespective of the fact that as on later date its net worth falls below the criteria specified.

In view of the above, the Company A will be required to follow Ind AS from financial year 2016-17.

It may be noted that Issue 8 of ITFG Clarification Bulletin 3 addressed an issue wherein as on March 31, 2014 an entity was listed, however subsequently the entity got delisted before the mandatory applicability date. In the said issue, it was clarified 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 this regard, it may be clarified the above guidance was related to only listing criteria and the same is not related to net worth criteria.

*(ITFG Clarification Bulletin 6, Issue 1)
(Date of finalisation: November 29, 2016)*

Applicability of Ind AS - In Case of Negative net worth

Issue 23: Will the following companies with negative net worth need to comply with Ind AS?

(a) Company A (listed) having negative net worth of ` 600 crore.

(b) Company B (unlisted) having negative net worth of ` 300 crore.

Response: Rule 4(1) (ii) and Rule 4(1) (iii) of Companies (Indian Accounting Standards) Rules, 2015, state as follows:

(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*
- (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 sub- clause (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;*

As per Rule 2(1) (f) of Companies (Indian Accounting Standards) Rules, 2015, “net worth” shall have the meaning assigned to it in clause (57) of section 2 of the Act.

Section 2(57) of Companies Act, 2013, defines ‘net worth’ as follows:

“net worth” means the aggregate value of the paid-up share capital and all reserves created out of the profits and securities premium account,

after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation;

In accordance with above provisions, it is clear that Ind AS will be applicable to companies (both listed and unlisted) from financial year 2016-17, if net worth is ` 500 crore or more. Therefore, if the net worth of the listed or unlisted company is negative, then Ind AS will not be applicable from F.Y. 2016-17. Accordingly, Ind AS will not be applicable to Company A (listed) and Company B (unlisted) from F.Y. 2016-17.

However, as per the roadmap, Ind AS will be applicable from financial year 2017-18 to all listed companies having net worth less ` 500 crore and unlisted companies having net worth ` 250 crore or more but less than rupees 500 crore. Accordingly, Ind AS will be applicable to Company A (listed) from F.Y. 2017-18, whereas Ind AS will not be applicable to Company B (unlisted) unless net worth criteria being met by Company B subsequently or Ind AS becoming applicable as part of the Group (e.g. holding of Company B is covered under Ind AS) or Company B voluntarily decides to apply Ind AS.

*(ITFG Clarification Bulletin 4, Issue 3)
(Date of finalisation: August 19, 2016)*

Applicability of Ind AS- Net worth Criteria

Issue 24: Company X, on standalone basis, had a net worth of above ` 250 crore but below ` 500 crore in financial year 2013-14 as well as financial year 2014-15 and is expected to exceed ` 500 crore in financial year 2015-16.

Whether the Company X be required to comply with Ind AS from financial year 2017-18 i.e. under Phase II, given that the net worth as on 31st March 2014 was below ` 500 Crore and the Company X was a company existing as on 31st March 2014 and was already falling under the threshold as on 31st March 2014 itself irrespective of the fact that the net-worth as on 31st March 2016 might be above ` 500 crore.

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

“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 requirement at (b) above, any company that meets the thresholds as specified in the Rules in a particular financial year, The Companies (Indian Accounting Standards) Rules, 2015, will become applicable to such company in immediately next financial year.

Therefore, in the given case, company X which had net worth of above ` 250 crore but below ` 500 crore in financial year 2013-14 as well as financial year 2014-15 and is expected to exceed ` 500 crore in financial year 2015-16, will have to prepare financial statements on the basis of Indian Accounting Standards (Ind AS), from the financial year beginning on April 1, 2016.

*(ITFG Clarification Bulletin 1, Issue 1)
(Date of finalisation: January 16, 2016)*

Ind AS 101, First-time Adoption of Indian Accounting Standards

Date of Transition to Ind AS

Issue 25: Ind AS 101, *First-time Adoption of Indian Accounting Standards*, requires presentation of balance sheet at the date of transition to Ind AS. For a company, the date of transition is April 1, 2016. Normally, a balance sheet represents the end of day position. Is the balance sheet required to be prepared on the date of transition at the end of the day or the start of the day? (e.g. if the transition date is April 1, 2016, then balance sheet to be prepared will be close of day of April 1 or start of day of April 1 (i.e. closing of March 31)).

Response: As per paragraph 6 of Ind AS 101, An entity shall prepare and present an opening Ind AS Balance Sheet at the date of transition to Ind ASs. This is the starting point for its accounting in accordance with Ind ASs subject to the requirements of paragraphs D13AA and D22. Further an example is provided under paragraph 8 of Ind AS 101 which provides as follows:

*The end of entity A's first Ind AS reporting period is 31 March 2017. Entity A decides to present comparative information in those financial statements for one year only (see paragraph 21). **Therefore, its date of transition to Ind ASs is the beginning of business on 1 April 2015 (or, equivalently, close of business on 31 March 2015).** Entity A presented financial statements in accordance with its previous GAAP annually to 31 March each year up to, and including, 31 March 2016.*

As per the relevant paragraph and example given in Ind AS 101, balance sheet will be prepared as on date of transition to Ind AS, i.e. the beginning of business on 1 April 2016 (or, equivalently, close of business on 31 March 2016).

*(ITFG Clarification Bulletin 8, Issue 3)
(Date of finalisation: May 05, 2017)*

Adjustments due to other Ind AS if deemed cost exemption availed

Issue 26: 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.

(ITFG Clarification Bulletin 12, Issue 10)

(Date of finalisation: October 23, 2017)

Date for assessment of functional currency

Issue 27: ABC Ltd. having net worth of ` 500 crores as on March 31, 2014 wants to assess its functional currency. From which date should company ABC Ltd. assess its functional currency, i.e. whether from date of transition or retrospectively as per paragraph 10 of Ind AS 101, *First-time Adoption of Indian Accounting Standards*?

Response: Paragraphs 13-19 of Ind AS 101 *First-time Adoption of Indian Accounting Standards* provide 'Exceptions to the retrospective application of other Ind ASs' and Appendices B-C of Ind AS 101 *First-time Adoption of Indian Accounting Standards*, provide certain 'Exceptions to retrospective application of other Ind ASs' and 'Exemptions for Business Combination' respectively.

Paragraphs 13-19 and Appendices B-C are silent on the assessment of functional currency by an entity, i.e., from date of transition or retrospectively. Since neither any exception nor any exemption has been specified for assessment of functional currency, an entity will have to assess its functional currency retrospectively as per paragraph 10 of Ind AS 101 stated as below.

Paragraph 10 of Ind AS 101, *First-time Adoption of Indian Accounting Standards*, states 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”.*

(ITFG Clarification Bulletin 1, Issue 5)

(Date of finalisation: January 16, 2016)

Accounting treatment of the balance outstanding in the “Revaluation Reserve” and deferred tax on this transition revaluation reserve

Issue 28: A company is a first-time adopter of Ind AS. It has opted for exemption under paragraph D7AA of Ind AS 101, *First-time Adoption of Indian Accounting Standards* and also elected the cost model under Ind AS 16, *Property, Plant and Equipment* for subsequent measurement. On the date of transition to Ind AS:

- (i) What will be the accounting treatment of the balance outstanding in the “Revaluation Reserve” created as per previous GAAP?
- (ii) What will be the treatment of deferred tax on this transition revaluation reserve?

Response: Paragraph 10 of Ind AS 101, *First-time Adoption of Indian Accounting Standards* 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.*

Further paragraph 11 of Ind AS 101 provides that, the accounting policies that

an entity uses in its opening Ind AS Balance Sheet may differ from those that it used for the same date using its previous GAAP. The resulting adjustments arise from events and transactions before the date of transition to Ind ASs. Therefore, an entity shall recognise those adjustments directly in retained earnings (or, if appropriate, another category of equity) at the date of transition to Ind ASs.

Accordingly, as per the above requirements in the given case balance outstanding in the revaluation reserve should be transferred to retained earnings or if appropriate, another category of equity disclosing the description of the nature and purpose of such amount in accordance with the requirements of paragraph 79(b), Ind AS 1, *Presentation of Financial Statements*. This is because after transition, the Company is no longer applying the revaluation model of Ind AS 16, instead it has elected to apply the cost model approach.

It may be noted that the requirements of Companies Act, 2013 for declaration of dividend will be required to be evaluated separately.

Further, it may also be noted that in accordance with Ind AS 12, *Income Taxes*, deferred tax would need to be recognised on any difference between the carrying amount and tax base of assets and liabilities. No deferred tax is created on equity components. However, since the asset has been revalued, there will be difference for the amount between carrying value and tax base. Hence, deferred tax will have to be recognised on such asset.

(ITFG Clarification Bulletin 8, Issue 7)

(Date of finalisation: May 05, 2017)

Applicability of Ind AS 109, Financial Instruments, if financial instruments have been acquired as part of the business combinations and the exemption under paragraph C1 of Ind AS 101 availed

Issue 29: 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.

(ITFG Clarification Bulletin 12, Issue 9)

(Date of finalisation: October 23, 2017)

Accounting Treatment of the government grant received before the date of transition and measurement of property, plant and equipment at the date of transition to Ind AS

Issue 30: 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.

(ITFG Clarification Bulletin 12, Issue 2)
(Date of finalisation: October 23, 2017)

Reversal of the impairment provision recognised in books as at the date of transition when exemption under paragraph D6 of Ind AS 101 availed

Issue 31: MNC Ltd. is a first-time adopter of Ind AS. It has elected to measure its property, plant and equipment at deemed cost measured as per paragraph D6 of Ind AS 101, i.e. at its previous GAAP revaluation amount measured before the date of transition (assuming the revaluation is broadly comparable to cost in accordance with Ind AS). Whether it can reverse the impairment provision recognised in books as at the date of transition.

Would the answer be different if the company has not opted for the deemed cost exemption given under Ind AS 101 and has elected to apply Ind AS 16 retrospectively?

Response: Ind AS 101, *First-time Adoption of Indian Accounting Standards* 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.”

As per paragraph D6 of Ind AS 101, “A first-time adopter may elect to use a previous GAAP revaluation of an item of property, plant and equipment at, or before, the date of transition to Ind ASs as deemed cost at the date of the revaluation, if the revaluation was, at the date of the revaluation, broadly comparable to:

- (a) fair value; or
- (b) cost or depreciated cost in accordance with Ind ASs, adjusted to reflect, for example, changes in a general or specific price index.”

In accordance with the above, an entity may elect to measure its property, plant and equipment at its deemed cost measured as per previous GAAP revaluation on or before the date of transition, if the revaluation was broadly comparable to fair value or cost or depreciated cost in accordance with Ind AS. The amount so elected as deemed cost is the cost and any accumulated depreciation and provision for impairment under previous GAAP have no relevance. Accordingly, provision for impairment provided before the date of such measurement as per previous GAAP cannot be reversed in later years.

It may be noted that FAQ on deemed cost of property, plant and equipment under Ind AS 101, *First-time Adoption of Indian Accounting Standards* issued by the Accounting Standards Board of ICAI also, *inter alia*, provides that from the date of transition, the deemed cost, i.e., carrying values of PPE as per the previous GAAP is the cost and any accumulated depreciation and provision for impairment under previous GAAP have no relevance as would be the case if fair value were to be taken as deemed cost as per paragraph D5.

Accordingly, provision for impairment provided before the date of transition as per previous GAAP cannot be reversed in later years.

However, from the deemed cost determination date to the date of transition, the entity shall apply appropriate Ind AS accounting policies and depreciation policies to that asset. The depreciation policy applied during the intervening period from the deemed cost determination date to the date of transition would have to be in accordance with the requirements of applicable Ind AS. Accordingly, the impairment loss for the period between the deemed cost determination date to the date of transition can be reversed, if permitted as per the provisions of Ind AS 36, *Impairment of Assets*.

However, if it follows that if Ind AS 16 was applied retrospectively in accordance with paragraphs 7 and 10 of Ind AS 101, then impairment loss can be reversed, if permitted as per the provisions of Ind AS 36, *Impairment of Assets*.

(ITFG Clarification Bulletin 8, Issue 5)
(Date of finalisation: May 05, 2017)

Availment of deemed cost exemption for the assets classified as 'Assets held for sale' but which do not fulfill the criteria for classifying as held for sale in accordance with Ind AS 105 on the date of transition

Issue 32: Company X is a first-time adopter of Ind AS from the financial year 2017-18 with the transition date being 1 April 2016. On 1 January 2016, Company X has classified a group of assets as 'Assets held for sale' in accordance with AS 10, *Property, Plant and Equipment* and stated it at lower of their net book value and net realisable value under previous GAAP. Company X has presented these assets separately from other fixed assets in the previous GAAP financial statements for

the year ended 31 March 2016 and did not provide depreciation subsequently on the same.

On transition to Ind AS, these assets could not fulfill the criteria for classifying as held for sale in accordance with Ind AS 105, *Non-current Assets Held for Sale and Discontinued Operations* and accordingly, would be reclassified as 'Property, plant and equipment'.

Whether deemed cost exemption under paragraph D7AA of Ind AS 101 will be available for these assets?

Response: Under previous GAAP, i.e., AS 10, *Property, Plant and Equipment*, the Company X presented items of fixed assets retired from active use and held for sale separately. In this regard, paragraphs 73 and 74 of AS 10 may be noted:

- "73 Items of property, plant and equipment retired from active use and held for disposal should be stated at the lower of their carrying amount and net realisable value. Any write-down in this regard should be recognised immediately in the statement of profit and loss.
- 74 The carrying amount of an item of property, plant and equipment should be derecognised
- (a) on disposal; or
 - (b) when no future economic benefits are expected from its use or disposal."

In accordance with the above, it may be noted that such fixed assets are shown separately and are not derecognised from financial statements; these are eliminated from the financial statements only if they are disposed off or no future economic benefits are expected from its use or disposal.

Paragraph D7AA of Ind AS 101, *First-time Adoption of Indian Accounting Standards*, provides 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 Ind AS 101."

In accordance with above, the exemption as per paragraph D7AA is available to all property, plant and equipment as recognised in the financial statements as at the date of transition to Ind AS irrespective of whether these were

disclosed separately. Under the previous GAAP, Company X has only presented the assets as held for sale separately. Accordingly, the Company X can avail the deemed cost exemption for such type of assets which were presented separately as held for sale as per previous GAAP but on transition did not meet the criteria of assets held for sale given under Ind AS 105, *Non-current Assets Held for Sale and Discontinued Operations*.

(ITFG Clarification Bulletin 10, Issue 4)

(Date of finalisation: July 05, 2017)

Applicability of paragraph D7AA for capital work in progress

Issue 33: 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.

(ITFG Clarification Bulletin 3, Issue 11)

(Date of finalisation: June 22, 2016)

Deemed cost exemption under paragraph D7AA (Treatment of intragroup profits)

Issue 34: 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.

(ITFG Clarification Bulletin 12, Issue 5)

(Date of finalisation: October 23, 2017)

Reversal of impact of paragraph 46A of AS 11 when exemption as per paragraph D7AA of Ind AS 101 availed

Issue 35: Company X had opted the option available under paragraph 46/46A of AS 11, *The Effects of Changes in Foreign Exchange Rates* notified under the Companies (Accounting Standards) Rules, 2006. Accordingly, exchange gain/loss on foreign currency borrowings had been added to or deducted from the cost of property, plant and equipment (PPE).

Company X is a first-time adopter of Ind AS and has availed the exemption given under paragraph D7AA of Ind AS 101 *First-time Adoption of Indian Accounting Standards*, however, it wishes to retrospectively reverse the effect of paragraph 46/46A from its PPE. Whether Company X is allowed to do so?

Response: Paragraph D7AA of Ind AS 101 states as follows:

*“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 when an entity opts for deemed cost exemption under paragraph D7AA of Ind AS 101 then it cannot make any adjustments to the carrying amount of PPE. Thus, once the entity avails the exemption provided in paragraph D7AA, it will be carrying forward the previous GAAP carrying amount for all of its property, plant and equipment.

Accordingly, in the given case, Company X cannot reverse the impact of paragraph 46A of AS 11 from its PPE as it has opted for the deemed cost exemption provided under D7AA.

*(ITFG Clarification Bulletin 7, Issue 3)
(Date of finalisation: March 30, 2017)*

Selective adoption of deemed cost exemption under paragraph D7AA

Issue 36: Ind AS has given the option to consider previous GAAP carrying value of property, plant and equipment (PPE) as deemed cost for assets acquired before the transition date. Whether an entity has the option of fair valuing few items of PPE and taking carrying amounts of

the remaining items of PPE as the deemed cost on the date of transition?

Response: No. In accordance with paragraph D7AA of Ind AS 101, *The First-time Adoption of Indian Accounting Standards*, where there is no change in its functional currency on the date of transition to Ind AS, a first-time adopter of Ind AS has the option to elect to continue with the carrying value of *all* of its property, plant and equipment as at the date of transition measured as per the previous GAAP and use that as its deemed cost at the date of transition after making necessary adjustments in accordance with paragraph D21 and D21A of Ind AS 101. If a first time adopter chooses this option, then the option of applying this on selective basis to some of the items of property, plant and equipment and using fair value for others is not available.

(ITFG Clarification Bulletin 5, Issue 3)

(Date of finalisation: September 19, 2016)

Treatment of Government Grant on the date of transition- In case of deemed cost exemption

Issue 37: ABC Ltd. is a first-time adopter of Ind AS from the financial year 2016-17. It had received 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 chosen to continue with carrying value of property, plant and equipment as per the previous GAAP as provided in paragraph D7AA of Ind AS 101. 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 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, when the option of deemed cost exemption is availed for property, plant and equipment under paragraph D7AA of Ind AS 101, no further adjustments to the deemed cost of the property, plant and equipment shall be made for transition adjustments that might arise from the application of other Ind AS.

However paragraph 10 of Ind AS 101, *inter alia*, provides that Ind AS will be applied in measuring all recognised assets and liabilities except for mandatory exceptions and voluntary exemptions from other Ind AS as prescribed under Ind AS 101.

In absence of any other mandatory exception or voluntary exemption 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*. In the current case, the company has already deducted the amount of grant from the cost of the fixed assets. As a consequence, to recognise the amount of unamortised deferred income as at the date of the transition in accordance with paragraph 10 of Ind AS 101, the corresponding adjustment should be made to the carrying amount of property, plant and equipment (net of cumulative depreciation

impact) and retained earnings, respectively, as the grant is directly linked to the property, plant and equipment. This treatment would reflect the correct economic reality and result in faithful representation of the effects of these transactions on transition in accordance with the requirements of Ind AS. Since the adjustment to the property, plant and equipment is only consequential and arising because of applying the transition requirements of Ind AS 101, it would not be construed as an adjustment to the deemed cost of property, plant and equipment as envisaged under paragraph D7AA of Ind AS.

(ITFG Clarification Bulletin 5, Issue 5)

(Date of finalisation: April 08, 2017)

Treatment of unadjusted processing of fees on loans taken before the date of transition -In case of deemed cost exemption

Issue 38: PQR Ltd. had obtained a loan prior to April 1, 2015. The processing fees on the loan were capitalised as part of the relevant fixed assets as per the previous GAAP. PQR Ltd. is required to adopt Ind AS from financial year 2016-17. It has chosen to avail deemed cost exemption provided in paragraph D7AA of Ind AS 101, i.e., to continue with carrying value of property, plant and equipment as per the previous GAAP. The loan needs to be accounted for as per amortised cost method in accordance with Ind AS 109, *Financial Instruments*.

Whether PQR Ltd. is required to adjust the carrying amount of fixed assets as per the previous GAAP to reflect accounting treatment of processing fees as per Ind AS 109?

Response: Paragraph 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, when the option of deemed cost exemption is availed for property, plant and equipment under paragraph D7AA of Ind AS 101, no further adjustments to the deemed cost of the property, plant and equipment shall be made for transition adjustments that might arise from the application of other Ind AS.

However paragraph 10 of Ind AS 101, *inter alia*, provides that Ind AS will be applied in measuring all recognised assets and liabilities except for mandatory exceptions and voluntary exemptions from other Ind AS as prescribed under Ind AS 101.

In absence of any other mandatory exception or voluntary exemption applicable in this case, the carrying amount of loan is required to be restated to its amortised cost in accordance with the requirements of Ind AS 109 as at the date of the transition. Accordingly, the unamortised amount of processing cost as at the date of the transition should be adjusted from the carrying amount of loan to arrive at its amortised cost. In the current case, the Company has already capitalised the processing cost as a part of the cost of the fixed assets. As a consequence, to restate the carrying amount of loan in accordance with paragraph 10 of Ind AS 101, the carrying amount of fixed assets as at the date of the transition should also be reduced by the amount of processing cost (net of cumulative depreciation impact). The difference between the adjustments to the carrying amount of loan and to fixed assets, respectively should be recognised in the retained earnings as at the date of the transition. This treatment would reflect the correct economic reality and result in faithful representation of the effects of these transactions on transition in accordance with the requirements of Ind AS. Since the adjustment to fixed assets is only consequential and arising because of applying the transition requirements of Ind AS 101, it would not be construed as an adjustment to the deemed cost of property, plant and equipment as envisaged under paragraph D7AA of Ind AS.

(ITFG Clarification Bulletin 5, Issue 4)

(Date of finalisation: April 08, 2017)

Applicability of paragraph D13AA on long term foreign exchange contracts

Issue 39: ABC Ltd. is a first time adopter of Ind AS. It has been exercising the option provided in paragraph 46/46A of AS 11, *The Effects of Changes in Foreign Exchange Rates* notified under the Companies (Accounting Standards) Rules, 2006 and intends to continue the same accounting policy in accordance with paragraph D13AA of Ind AS 101, *First-time Adoption of Indian Accounting Standards*. The entity used to apply the provisions of paragraph of 46/46A of AS 11 to long-term forward exchange contracts as such contracts were also covered by paragraph 36 of AS 11. Whether ABC Ltd. can continue the accounting policy for exchanges differences to long term forward exchange contracts?

Response: Paragraph D13AA of Ind AS 101 states as follows:

“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.”

The exemption in D13AA relates to accounting for foreign exchange differences on long term foreign currency monetary items recognised in the financial statement only, and it does not relate to the accounting for long term forward exchange contracts (as these contracts are not within scope of Ind AS 21 and are treated in accordance with Ind AS 109). Therefore, an entity cannot continue to apply the provisions of paragraph 46/46A of AS 11 to long-term forward exchange contracts by virtue of availing exemption given in paragraph D13AA of Ind AS 101.

Further, following paragraphs of Ind AS 21 would be relevant when accounting for long term forward exchange contracts:

Paragraph 3 of Ind AS 21, *inter alia*, states that Ind AS 21 shall be applied in accounting for transactions and balances in foreign currencies, except for those derivative transactions and balances that are within the scope of Ind AS 109, *Financial Instruments*.

Paragraph 4 of Ind AS 21 states as follows:

“Ind AS 109 applies to many foreign currency derivatives and, accordingly, these are - excluded from the scope of this Standard. However, those foreign

currency derivatives that are not within the scope of Ind AS 109 (e.g. some foreign currency derivatives that are embedded in other contracts) are within the scope of this Standard. In addition, this Standard applies when an entity translates amounts relating to derivatives from its functional currency to its presentation currency.”

Long term forward exchange contracts generally meet the definition of ‘Derivatives’ which are within the scope of Ind AS 109, *Financial Instruments*. Therefore, ABC Ltd has to follow the accounting requirements of Ind AS 109 for accounting long term forward exchange contracts.

(ITFG Clarification Bulletin 7, Issue 4)

(Date of finalisation: March 30, 2017)

Capitalisation of exchange differences arising from long term foreign currency monetary items (In case of first-time adoption of Ind AS and when change in functional currency)

Issue 40: Company ZED Ltd., having net worth of ` 600 crores as on March 31, 2014, has assessed that its functional currency as per the requirements of Ind AS 21, *The Effects of Changes in Foreign Exchange Rates*, is USD. The Company has taken loans in USD as well as in ` for importing fixed assets before 1st March 2014. The Company follows the policy of recognising the exchange differences arising from long term foreign currency monetary items in the cost of fixed assets where such monetary item has arisen for purchase of fixed assets. Considering the requirements of paragraph D13AA of Ind AS 101, *First-time Adoption of Indian Accounting Standards*, whether the company can continue to recognise the exchange differences arising from the above said loans in the cost of Property, Plant and Equipment, when adopting Ind AS for the first time?

Response: Paragraph D13AA of Ind AS 101, *First-time Adoption of Indian Accounting Standards* states as follows:

“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 D13AA as stated above provides an option to continue the policy of recognising the exchange differences on long term foreign currency

monetary items as per paragraph 46/46A of AS 11, *The Effects of Changes in Foreign Exchange Rates*, only for those long term foreign currency monetary items which were recognised in the financial statements before the beginning of first Ind AS reporting period. Therefore, the option given in paragraph D13AA of Ind AS 101, will be available in case of those long term foreign currency monetary items which were recognised in the financial statements ending on or before 31st March, 2016 and are regarded as foreign currency monetary items under Ind AS 21.

In the given case, the functional currency of Company ZED has changed from ` to USD. Therefore, the USD loans will no longer be regarded as foreign currency monetary items under Ind AS. Hence, such a company cannot continue the policy of recognising the exchange differences, arising from USD loans, in the cost of fixed assets.

(ITFG Clarification Bulletin 1, Issue 4)
(Date of finalisation: January 16, 2016)

Exemption under paragraph D13AA to foreign currency loan drawn after Ind AS applicability to the entity

Issue 41: Company ABC Ltd. is required to mandatorily comply with Ind AS from financial year 2016-17. It had entered into a foreign currency loan agreement for USD 100 million on March 31, 2010 for construction of its property, plant and equipment (PPE). It had drawn USD 70 million upto March 31, 2016. The company had availed the option given under paragraph 46/46A of AS 11, *The Effects of Changes in Foreign Exchange Rates* notified under the Companies (Accounting Standards) Rules, 2006. Accordingly, exchange gain/loss on such foreign currency loan had been added to or deducted from the cost of PPE. The Company has opted for the exemption given under paragraph D13AA of Ind AS 101, *First-time Adoption of Indian Accounting Standards*.

The balance amount of USD 30 million will be drawn after 1st April, 2016. Whether the exemption under paragraph D13AA is also available for the balance loan amount of USD 30 million to be drawn after 1st April, 2016?

Response: Paragraph D13AA of Ind AS 101 states as follows:

“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.”

As stated above, it may be noted that the exemption under paragraph D13AA is available only for the exchange differences arising from translation of long-term foreign currency monetary items recognised in the financial statements immediately before the beginning of the first Ind AS financial reporting period.

Accordingly, in the given case, the exemption under paragraph D13AA for the exchange gain/loss on foreign currency loan amount of USD 70 million is available to ABC Ltd. However, it cannot avail the exemption under paragraph D13AA for the exchange gain/loss on balance amount of loan, i.e., USD 30 million, as the same will be drawn after 1st April, 2016.

(ITFG Clarification Bulletin 7, Issue 1)

(Date of finalisation: March 30, 2017)

Applicability of paragraph D13AA on foreign currency swaps in case of hedged items

Issue 42: 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.

(ITFG Clarification Bulletin 3, Issue 10)

(Date of finalisation: June 22, 2016)

Revision of balance of Foreign Currency Monetary Item Translation Difference Account (FCMITDA) at the time of first time adoption of Ind AS on account of finance cost

Issue 43: A Company has opted for the accounting treatment under paragraph 46A of AS 11, *The Effects of Changes in Foreign Exchange*

Rates, under the Companies (Accounting Standards) Rules, 2006, in respect of purchase of other than depreciable assets and accordingly, exchange difference on account of long term foreign currency loans is accumulated and amortised over the balance period of such loan. The company has taken a long term loan of ` 1000 crores and incurred upfront / processing fee of ` 40 crores. Under the Companies (Accounting Standards) Rules, 2006, ` 40 crores had been charged off as finance cost in the statement of profit and loss in the year of loan and ` 1000 crores is carried as long term loan. The loan which is outstanding on the balance sheet date (for simplicity it is assumed that repayment of loan has not yet started) is translated at the rate of exchange prevailing at the date of balance sheet and the exchange difference is parked in Foreign Currency Monetary Item Translation Difference Account (FCMITDA), which is being amortised over the term of loan.

Under the Companies (Indian Accounting Standards) Rules, 2015, on the date of transition, the effective rate of interest will be worked out based on the net inflow of loan amount i.e. ` 960 crores in this case.

Whether the balance of FCMITDA based on loan inflow of ` 960 crores or ` 1000 crores be continued as per Ind AS on date of transition as per the Paragraph D13AA of Ind AS 101, *First time Adoption of Indian Accounting Standards*.

Response: As per paragraph D13AA of Ind AS 101, *First time Adoption of Indian Accounting Standards*, “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”.

Long term loan taken by Company is a financial liability under Ind AS 109, *Financial Instruments*. Paragraphs 4.2.1 and 4.2.2 of Ind AS 109 provide for classification and subsequent measurement of financial liability as follows:

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

- (a) financial liabilities at fair value through profit or loss. Such liabilities, including derivatives that are liabilities, shall be subsequently measured at fair value.*

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- (b) *financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or when the continuing involvement approach applies. Paragraphs 3.2.15 and 3.2.17 apply to the measurement of such financial liabilities.*
- (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.*
- (d) *commitments to provide a loan at a below-market interest rate. An issuer of such a commitment shall (unless paragraph 4.2.1(a) 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.*
- (e) *contingent consideration recognised by an acquirer in a business combination to which Ind AS 103 applies. Such contingent consideration shall subsequently be measured at fair value with changes recognised in profit or loss.*

Option to designate a financial liability at fair value through profit or loss

4.2.2 An entity may, at initial recognition, irrevocably designate a financial liability as measured at fair value through profit or loss when permitted by paragraph 4.3.5, or when doing so results in more relevant information, because either:

- (a) *it eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as ‘an accounting mismatch’) that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases (see paragraphs B4.1.29– B4.1.32); or*
- (b) *a group of financial liabilities or financial assets and financial liabilities is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment*

strategy, and information about the group is provided internally on that basis to the entity's key management personnel (as defined in Ind AS 24 Related Party Disclosures), for example, the entity's board of directors and chief executive officer (see paragraphs B4.1.33–B4.1.36)".

In view of the above, the first time adopter needs to revise the balance of FCMITDA based on the loan at amortised cost of ` 960 crores retrospectively if the loan is not designated as at fair value through profit or loss (FVTPL).

(ITFG Clarification Bulletin 2, Issue 6)

(Date of finalisation: April 12, 2016)

Amortisation of balance of Foreign Currency Monetary Item Translation Difference Account (FCMITDA)

Issue 44: Y Ltd. is a first time adopter of Ind AS. The date of transition is April 1, 2015. On April 1, 2010, it obtained a 7 year US\$ 1,00,000 loan. It has been exercising the option provided in Paragraph 46/46A of AS 11 and has been amortising the exchange differences in respect of this loan over the balance period of such loan. On the date of transition, the company intends to continue the same accounting policy with regard to amortising of exchange differences. Whether the Company is permitted to do so? Whether amortisation of balance of Foreign Currency Monetary Item Translation Difference Account (FCMITDA) be routed through profit or loss or through Other Comprehensive Income (OCI).

Response: Ind AS 101 includes an optional exemption to continue the existing policy as per the previous GAAP, i.e., existing AS 11 in respect of the 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.

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. Therefore, if an entity opts to follow the aforesaid paragraph of Ind AS 101, it has to continue to apply the accounting policy followed for such long-term foreign currency monetary item.

In view of the above, Company Y can continue to follow the existing

accounting policy of amortising the exchange differences in respect of this loan over the balance period of such long term liability.

Since the amortisation of exchange differences under the existing policy as per the previous GAAP would be to recognise periodic amortised amount in the statement of profit and loss affecting the profit or loss for the period, amortisation of balance of Foreign Currency Monetary Item Translation Difference Account (FCMITDA) shall be routed through profit or loss and not through Other Comprehensive Income (OCI).

(ITFG Clarification Bulletin 2, Issue 1)

(Date of finalisation: April 12, 2016)

Capitalisation of exchange differences arising from long term foreign currency monetary items in case of fixed assets (In case of first time adoption of Ind AS)

Issue 45: Company XYZ Ltd. having net worth of ` 600 crores as on March 31, 2014 has taken a loan having term of 5 years for importing fixed assets as on July 1, 2014, February 1, 2016 and May 3, 2016. The Company has followed the policy of recognising the exchange differences arising from long term foreign currency monetary items in the cost of fixed assets where such monetary item has arisen for purchase of fixed assets pursuant to paragraph 46/46 A of AS 11, *The Effects of Changes in Foreign Exchange Rates*, notified under the Companies (Accounting Standards) Rules, 2006. Considering the requirements of paragraph D13AA of Ind AS 101, *First-time adoption of Indian Accounting Standards*, whether the company can continue to recognise the exchange differences arising from the above-said loans in the cost of Property, Plant and Equipment, when adopting Ind AS for the first time?

Response: Paragraph D13AA of Ind AS 101, *First-time Adoption of Indian Accounting Standards* states as follows:

“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 D13AA of Ind AS 101, *First-time adoption of Indian Accounting*

Standards, provides an option to continue the policy of recognising the exchange differences on long term foreign currency monetary items as per paragraph 46/46A of AS 11, *The Effects of Changes in Foreign exchange Rates*, only for those long term foreign currency monetary items which were recognised in the financial statements before the beginning of first Ind AS reporting period.

In the above case, the beginning of the first Ind AS reporting period for company XYZ is April 1, 2016. Therefore, the option given in paragraph D13AA of Ind AS 101 will be available for loans taken as on July 1, 2014 and February 1, 2016 and will not be available for the loan taken after March 31, 2016.

(ITFG Clarification Bulletin 1, Issue 3)

(Date of finalisation: January 16, 2016)

Accounting Treatment of interest free loan to subsidiary company when exemption under paragraph D15 of Ind AS 101 availed

Issue 46: A Ltd. has given an interest free loan to its subsidiary company B Ltd. Both companies are covered under Phase I of Ind AS roadmap. B Ltd. has recognised the differential of present value of loan amount and its carrying amount as per previous GAAP as 'Equity' in its standalone financial statements prepared as per Ind AS. A Ltd. has elected to measure the investment in subsidiary at its previous GAAP carrying amount at that date in accordance with paragraph D15 of Ind AS 101, *First-time Adoption of Indian Accounting Standards*.

What will be the accounting treatment of the differential in the carrying value of loan under previous GAAP and its present value in the standalone financial statements of A Ltd. prepared as per Ind AS?

Response: Paragraphs D14 and D15 of Ind AS 101 state as follows:

"D14 When an entity prepares separate financial statements, Ind AS 27 requires it to account for its investments in subsidiaries, joint ventures and associates either:

- (a) at cost; or*
- (b) in accordance with Ind AS 109."*

D15 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."

Paragraph 10 of Ind AS 101 states 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 accordance with the above, it may be noted that if the entity exercises the option under D15 (b) (ii) to measure the investment in subsidiary at previous GAAP carrying amount, then the differential in the carrying value of the loan under previous GAAP and present value shall be added to the investment in subsidiary measured at cost as required by paragraph 10 of Ind AS 101.

(ITFG Clarification Bulletin 10, Issue 1)

(Date of finalisation: July 05, 2017)

Measurement of Investment in subsidiary when exemption under paragraph D15 of Ind AS 101 availed

Issue 47: MNC Ltd is a first-time adopter of Ind AS. At the date of transition to Ind AS, it has opted to measure its investment in subsidiary at deemed cost as per paragraph D15 of Ind AS 101, *First-time Adoption of Indian Accounting Standards*. Whether in its first Ind AS financial statements prepared as at the end of the reporting period,

MNC Ltd. is required to measure its investment in subsidiary at cost only or it has the option to measure the investment as per Ind AS 109 in accordance with paragraph 10 of Ind AS 27?

Response: Paragraph D14 and D 15 of Ind AS 101 states as follows:

“D14 When an entity prepares separate financial statements, Ind AS 27 requires it to account for its investments in subsidiaries, joint ventures and associates either:

- (a) at cost; or*
- (b) in accordance with Ind AS 109.*

*D15 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.”

In accordance with the above, it may be noted that deemed cost exemption under paragraph D15 is available to an entity when it chooses to measure the investment at cost in accordance with Ind AS 27. Accordingly, an entity may in its opening Ind AS balance sheet measure its investment in subsidiaries as at the date of transition at its deemed cost measured in accordance with paragraph D15 provided it adopts to measure its investment in subsidiaries at cost in accordance with Ind AS 27.

Further, paragraph 7 of Ind AS 101 states that, *“An entity shall use the **same accounting policies in its opening Ind AS Balance Sheet and throughout all periods presented in its first Ind AS financial statements**. Those accounting policies shall comply with each Ind AS effective at the end of its first Ind AS reporting period, except as specified in paragraphs 13–19 and Appendices B–D.”*

Accordingly, if an entity has opted to measure its investments in subsidiaries at cost for its opening Ind AS balance sheet, then the same accounting policy

will be applied for its closing Ind AS balance sheet as well. Accordingly, if a company chooses to measure its investment in subsidiary at the date of transition at deemed cost measured as per paragraph D15, then it shall carry such investment at that amount (i.e. deemed cost as per paragraph D15) in its first Ind AS financial statements prepared as at the end of the reporting period.

The requirements in D14 and D15 applies to investments held in subsidiaries as at the date of transition. However, for all investment in subsidiaries, joint ventures and associates made subsequent to the date of transition, the requirements of paragraph 10 of Ind AS 27 as stated below shall apply:

“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.”*

The entity shall apply the same accounting for each category of investments. Investments accounted for at cost shall be accounted for in accordance with Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations, when they are classified as held for sale (or included in a disposal group that is classified as held for sale). The measurement of investments accounted for in accordance with Ind AS 109 is not changed in such circumstances.”

In accordance with the above, if the entity has opted to measure the investments at deemed cost on the date of transition to Ind AS in its opening Ind AS balance sheet, then all subsequent investments made in that category should be measured at cost in accordance with Ind AS 27 in its financial statements prepared as at the end of the reporting period. However, for the investment made in different category (e.g. associate or joint venture), the entity has an option to account for those investments at cost or in accordance with Ind AS 109.

(ITFG Clarification Bulletin 11, Issue 4)

(Date of finalisation: July 31, 2017)

Exemption of paragraph D15 on investment in debentures of subsidiary company

Issue 48: XYZ Ltd. is a holding company of ABC Ltd. and owns 60% voting share of ABC Ltd. Apart of equity investments, XYZ Ltd. has investment in debentures of subsidiary company. Whether such an investment in debenture of subsidiary company would be covered

under the scope of paragraph 10 of Ind AS 27, *Separate Financial Statements* and exemptions provided under D15 of Ind AS 101, *First-time Adoption of Indian Accounting Standards*.

Response: According to paragraph 2.1(a) of Ind AS 109, the standard is not applicable to those interests in subsidiaries, associates and joint ventures that are accounted for in accordance with Ind AS 110, *Consolidated Financial Statements*, Ind AS 27, *Separate Financial Statements* or Ind AS 28, *Investments in Associates and Joint Ventures*.

However, in some cases, Ind AS 110, Ind AS 27 or Ind AS 28 require or permit an entity to account for an interest in a subsidiary, associate or joint venture in accordance with some or all of the requirements of this Standard i.e. Ind AS 109.

Paragraph 10 of Ind AS 27, *Separate Financial Statements*, *inter alia*, states as follows:

“10 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.”*

Further, paragraph D15 of Ind AS 101 provides exemption with regard to investments in subsidiaries, joint ventures and associates.

Paragraph D15 of Ind AS states as follows:

“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.”

The Company needs to assess the terms of the debentures to determine whether the instrument can be considered as an investment in subsidiary as per Ind AS 27 or a financial asset as per Ind AS 109. If the debentures meet the definition of equity as per Ind AS 32 from the issuer's perspective (i.e. subsidiary), then it can be considered to be part of parent's investment in subsidiary and hence accounted for under Ind AS 27. However, where the instrument fails to meet the definition of equity from issuer's perspective (i.e. a liability of the subsidiary), it shall be classified as a financial asset and accounted for under Ind AS 109.

Investments covered by Ind AS 110 are those interests that give an entity right to control over the other entity, which are normally in the form of equity investments. An entity may have other investments commonly referred as long term investments which are not excluded from the scope of Ind AS 109.

Accordingly, in the given case, presuming that investment in debentures is not within the scope of Ind AS 110, it will not be covered under Ind AS 27 and therefore, should be accounted as financial asset under Ind AS 109.

(ITFG Clarification Bulletin 7, Issue 8)

(Date of finalisation: March 30, 2017)

Exemption under paragraph D22 of Ind AS 101 in respect of intangible assets arising from service concession arrangements (toll roads) which are in progress.

Issue 49: A Ltd. is a first-time adopter of Ind AS from financial year 2016-17. It had entered into a service concession arrangement with government in respect of toll roads in the year 2014. Paragraph 7AA of Ind AS 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. As on 1st April 2016, the construction of toll road is in progress. Can A Ltd. avail the above exemption in respect of toll roads under construction/development as on 1st April, 2016?

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 amortisation 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.....”*

Further, paragraph 7AA 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.”

In accordance with the above, it may be noted that the exemption can be availed in respect of intangible assets arising from service concession arrangements in respect of toll roads recognised in the financial statements before the beginning of first Ind AS reporting period. In the given case, A Ltd. cannot avail the exemption because the intangible asset is in progress and the same have has not been recognised before 1st April, 2016 and amortisation has not begun.

*(ITFG Clarification Bulletin 7, Issue 9)
(Date of finalisation: March 30, 2017)*

Accounting treatment of non-controlling interest in case of business combinations in its consolidated financial statements as on the date of transition

Issue 50: Company A has multiple subsidiaries. All subsidiary companies have a negative net worth as at 31st March 2015. Company A is required to apply Ind AS from 1st April, 2016. How will the company account for accumulated losses as at 31st March 2015 pertaining (under the earlier GAAP) to the non-controlling interest in its consolidated financial statements as on the date of transition-

- (i) If Company A decides to avail the exemption for all business combination before the date of transition as per Appendix C of**

Ind AS 101, *First-time Adoption of Indian Accounting Standards*?

- (ii) **If Company A elects to apply Ind AS 103, *Business Combinations*, retrospectively to past business combinations i.e., restating the business combinations that occurred before the date of transition to Ind AS from the date of its choice ?**

Response: Paragraph B7 of Ind AS 101, *First-time Adoption of Indian Accounting Standards* on transition states:

“A first-time adopter shall apply the following requirements of Ind AS 110 prospectively from the date of transition to Ind ASs:

- (a) *the requirement in paragraph B94 that total comprehensive income is attributed to the owners of the parent and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance;*
- (b) *.....*
- (c) *.....*

However, if a first-time adopter elects to apply Ind AS 103 retrospectively to past business combinations, it shall also apply Ind AS 110 in accordance with paragraph C1 of this Ind AS.”

Paragraph C1 of Ind AS 101 further states:

“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.”

For example, if a first-time adopter elects to restate a business combination that occurred on 30 June 2010, it shall restate all business combinations that occurred between 30 June 2010 and the date of transition to Ind ASs, and it shall also apply Ind AS 110 from 30 June 2010.

Further paragraph C4 of Appendix C of Ind AS 101, states as follows:

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:

.....

- (c) *The first-time adopter shall exclude from its opening Ind AS Balance*

Ind AS 101, First-time Adoption of Indian Accounting Standards

Sheet any item recognised in accordance with previous GAAP that does not qualify for recognition as an asset or liability under Ind ASs. The first-time adopter shall account for the resulting change as follows:

(ii) the first-time adopter shall recognise all other resulting changes in retained earnings.

.....

(k) The measurement of non-controlling interests and deferred tax follows from the measurement of other assets and liabilities. Therefore, the above adjustments to recognised assets and liabilities affect non-controlling interests and deferred tax.”

In accordance with above, if a company elects to apply a date prior to the transition date for the purpose of applying Ind AS 103, non-controlling interests should be calculated after all assets acquired, liabilities assumed and deferred taxes have been adjusted under Ind AS 103, *Business Combinations*.

So, as per above paragraph, in the given case (i), if Company A decides to avail the exemption for business combination as per Appendix C of Ind AS 101, in respect of all business combinations that occurred before the date of transition, then the company shall apply the requirement in paragraph B94 of Ind AS 110 of attributing the total comprehensive income to the owners of the parent and to the non-controlling interests prospectively.

However, if Company A elects to apply Ind AS 103, *Business Combinations* retrospectively to past business combinations i.e., restating the business combinations that occurred before the date of transition to Ind AS from the date of its choice, then the company should account for attribution of losses to the non-controlling interest in accordance with paragraph B94 of Ind AS 110, retrospectively from the date of application of Ind AS 103, in its consolidated financial statements as on the date of transition.

(ITFG Clarification Bulletin 8, Issue 6)

(Date of finalisation: May 05, 2017)

Applicability of Appendix C of Ind AS 103 – in case of amalgamation on the date of transition

Issue 51: Company X is the wholly-owned subsidiary of Company Y and Promoters' hold 49.95% in Company Y as on 31st March 2015. Company Y merges with Company X on 1st April 2015 and amalgamation was in

the nature of purchase as per AS 14, *Accounting for Amalgamations*. Company X is required to adopt Ind AS from financial year 2017-18. The date of transition to Ind AS is April 1, 2016. Under Ind AS, Company X has not opted for the exemption under paragraph C1 of Ind AS 101, *First-time Adoption of Indian Accounting Standards*, of not applying Ind AS 103 retrospectively to past business combinations (business combinations that occurred before the date of transition to Ind AS).

Whether on the date of transition to Ind AS the company is required to apply requirements of Appendix C to Ind AS 103, *Business combinations of entities under common control* in the given case?

Response: Paragraph C1 of Ind AS 101 states that, “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.”

For example, if a first-time adopter elects to restate a business combination that occurred on 30 June 2010, it shall restate all business combinations that occurred between 30 June 2010 and the date of transition to Ind ASs, and it shall also apply Ind AS 110 from 30 June 2010.

In the given case, since the company has not taken exemption under paragraph C1 of not restating past business combinations accordingly, the company will be required to retrospectively apply the requirements of Ind AS 103.

Appendix C to Ind AS 103 deals with accounting for business combinations of entities or businesses under common control. Common control business combination means a business combination involving entities or businesses in which all the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory.

It is also pertinent to note that an investor with less than majority voting rights can also have control over the investee under Ind AS 110 (eg. through contractual arrangements, de facto control, potential voting rights etc. Accordingly, the company needs to evaluate whether they are under common control.

In the given case, assuming that the entities are under common control

Ind AS 101, First-time Adoption of Indian Accounting Standards

before and after the amalgamation and the company has not opted exemption under Ind AS 101 then the requirements of Appendix C to Ind AS 103 shall be applied retrospectively.

(ITFG Clarification Bulletin 15, Issue 6)

(Date of finalisation: April 04, 2018)

Ind AS 103, Business Combinations

Date of acquisition (i.e. date of obtaining control) under two scenario in case of court scheme, whether business combination is or is not under common control.

Issue 52: 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.

(ITFG Clarification Bulletin 12, Issue 8)
(Date of finalisation: October 23, 2017)

Business Combinations of entities under common control

Issue 53: As per Appendix C, *Business Combinations of Entities under Common Control* of Ind AS 103, *Business Combinations*, in case of common control business combinations, the assets and liabilities of the combining entities are reflected at their carrying amounts.

- (A) For this purpose, should the carrying amount of assets and liabilities of the combining entities be reflected as per the books of the entities transferred or the ultimate parent in the following situations:

Situation 1: A Ltd. has two subsidiaries B Ltd. and C Ltd. B Ltd. merges with C Ltd.

Situation 2: B Ltd. is the subsidiary of A Ltd. B Ltd. merges with A Ltd.

- (B) Further, also state whether the effect of the above business combination is required to be eliminated in the consolidated financial statements of A Ltd.

Response: (A) ***Situation 1:*** Paragraph 9 of Appendix C of Ind AS 103, states as follows:

- “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.”

Further paragraphs 11 and 12 of Appendix C of Ind AS 103 state as follows:

“11 The balance of the retained earnings appearing in the financial statements of the transferor is aggregated with the corresponding balance appearing in the financial statements of the transferee. Alternatively, it is transferred to General Reserve, if any.

12 The identity of the reserves shall be preserved and shall appear in the financial statements of the transferee in the same form in which they appeared in the financial statements of the transferor. Thus, for example, the General Reserve of the transferor entity becomes the General Reserve of the transferee, the Capital Reserve of the transferor becomes the Capital Reserve of the transferee and the Revaluation Reserve of the transferor becomes the Revaluation Reserve of the transferee. As a result of preserving the identity, reserves which are available for distribution as dividend before the business combination would also be available for distribution as dividend after the business combination. The difference, if any, between the amounts recorded as share capital issued plus any additional consideration in the form of cash or other assets and the amount of share capital of the transferor shall be transferred to capital reserve and should be presented separately from other capital reserves with disclosure of its nature and purpose in the notes.”

In accordance with the above, it may be noted that the assets and liabilities of the combining entities are reflected at their carrying amounts. Accordingly, in accordance with paragraph 9 (a) (i) of Appendix C of Ind AS 103, in the separate financial statements of C Ltd., the carrying values of the assets and

liabilities as appearing in the standalone financial statements of the entities being combined i.e. B Ltd. & C Ltd. in this case shall be recognised.

Situation 2:

In this case, since B Ltd. is merging with A Ltd. (i.e. parent) nothing has changed and the transaction only means that the assets, liabilities and reserves of B Ltd. which were appearing in the consolidated financial statements of Group A immediately before the merger would now be a part of the separate financial statements of A Ltd. Accordingly, it would be appropriate to recognise the carrying value of the assets, liabilities and reserves pertaining to B Ltd as appearing in the consolidated financial statements of A Ltd. Separate financial statements to the extent of this common control transaction shall be considered as a continuation of the consolidated group.

(B) Paragraph B86 of Ind AS 110, *Consolidated Financial Statements*, states as follows:

“Consolidation procedures

B86 Consolidated financial statements:

- (a) combine like items of assets, liabilities, equity, income, expenses and cash flows of the parent with those of its subsidiaries.*
- (b) offset (eliminate) the carrying amount of the parent’s investment in each subsidiary and the parent’s portion of equity of each subsidiary (Ind AS 103 explains how to account for any related goodwill).*
- (c) eliminate in full intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group (profits or losses resulting from intragroup transactions that are recognised in assets, such as inventory and fixed assets, are eliminated in full). Intragroup 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 intragroup transactions.”*

In accordance with the above, all intra-group transactions should be eliminated in preparing consolidated financial statement in accordance with Ind AS 110. The legal merger of a subsidiary with the parent or legal merger of fellow subsidiaries is an intra-group transaction and accordingly, will have to be eliminated in the Consolidated Financial Statements of the Parent.

Accordingly, in both the given situations, the effect of legal merger should be eliminated while preparing consolidated financial statements of A Ltd.

(ITFG Clarification Bulletin 9, Issue 2)
(Date of finalisation: May 15, 2017)

Incorporation of effect of business combination in the standalone financial statements in case of scheme of arrangement

Issue 54: Entity A and B are fellow subsidiaries (entities under common control) and filed a scheme of arrangement in April 2017 for merger of Entity B into Entity A. Both the entities are covered under phase I of Ind AS. Entity B filed auditor's certificate with NCLT pursuant to Section 230(7) of Companies Act, 2013 which states that the accounting treatment proposed in the scheme of compromise or arrangement is in conformity with the Ind AS.

Entity B gets approval from NCLT in April 2018, which is after the year-end 31st March, 2018 but before the approval (by the Board of Directors) of the financial statements for the year ended 31st March 2018. As per the scheme, the appointed date is 1st April 2017.

Whether the business combination of Entity B shall be incorporated in the Entity A's standalone financial statements for the year ended 31st March 2018?

Response: Paragraph 3 of Ind AS 10, *Events After the Reporting Period* states as follows:

"Events after the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are approved by the Board of Directors in case of a company, and, by the corresponding approving authority in case of any other entity for issue. Two types of events can be identified:

- (a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period); and*
- (b) those that are indicative of conditions that arose after the reporting period (non-adjusting events after the reporting period)."*

It may be noted that although paragraph 22(a) of Ind AS 10 states that a major business combination after the reporting period is a non-adjusting event. However, where the court order approves a scheme with retrospective effect subsequent to the balance sheet date but before the approval of financial statements, the effective date for accounting is prior to the balance

sheet date, wherein the courts' approval is an event that provide additional evidence to assist the estimation of amounts of assets and liabilities that existed at the balance sheet date. As such, an adjusting event has occurred which requires adjustment to the assets and liabilities of the transferor company which are being transferred.

In the given case, since the company has applied for the scheme of amalgamation and only the order of the court is pending then this indicates that conditions existed at the end of the reporting period and hence this shall be treated as an adjusting event. Accordingly, the effect of business combination of Entity B in Entity A shall be incorporated in the standalone financial statements of Entity A for the year ending 31st March 2018.

(ITFG Clarification Bulletin 14, Issue 4)

(Date of finalisation: February 01, 2018)

Account Treatment of Demerger

Issue 55: Company A is a subsidiary of Company B. Both are under Phase II of Ind AS implementation. During the year 2016-17, Company B demerged one of its businesses under the order of the High Court and sold the same to Company A. Under IGAAP, the assets and liabilities of the demerged business of Company B was taken by Company A at their fair value and issued its shares as consideration (calculated on the basis of the fair value of the business of Company B) accordingly. Under Ind AS 103, *Business Combinations*, acquisition of a business within the companies under Common Control has to be accounted by the acquirer at book value as appearing in the books of the acquiree. In facts of case the acquisition of business by subsidiary (Company A) from parent (Company B) qualifies as common control business combination within Appendix C of Ind AS 103.

Whether Company A is required to apply Ind AS 103 on the acquisition of the business from Company B?

Response: It is noted that the demerger (of one of the businesses of Company B into Company A) occurred during the financial year 2016-17. It is further noted that in their financial statements for the financial year 2016-17, the transferee company (Company A or the company) as well as the transferor company (Company B) were not required to, and did not apply, Indian Accounting Standards (Ind ASs) notified under the Companies (Indian Accounting Standards) Rules, 2015.

The Accounting Standards notified under the Companies (Accounting Standards) Rules, 2006 do not specifically deal with accounting for demerger. It has been mentioned in the query that “under IGAAP, the assets and liabilities of the demerged business of Company B were taken by Company A at their fair value and Company A issued its shares as consideration (calculated on the basis of the fair value of the business of Company B) accordingly.” We interpret this to mean that in its financial statements for the year 2016-17, Company A accounted for the assets and liabilities acquired under the scheme of demerger at their respective fair values as at the date of demerger.

It is noted that in the case of Company A, the first Ind AS financial statements would be those for the financial year 2017-18. In those financial statements, the comparative amounts to be presented as per Ind ASs would be those for the year 2016-17. It is also noted that the demerger occurred during the financial year 2016-17, i.e., after the ‘date of transition to Ind ASs’ by Company A (i.e., April 1, 2016) within the meaning of the said term under Ind AS 101, *First-time Adoption of Indian Accounting Standards*.

Scenario A: Accounting treatment of demerger not prescribed in the court-approved scheme

An entity can choose not to restate any business combination that occurred prior to its transition to Ind AS, and it can apply Ind AS 103 prospectively from the date of transition. In case the court-approved scheme of demerger did not prescribe the accounting treatment for the demerger in the books of Company A, the demerger is then no different from any other transaction occurring on or after the date of transition to Ind ASs. A transaction occurring on or after the date of transition to Ind ASs is required to be accounted for as per relevant requirements under Ind ASs, irrespective of how it was accounted for under previous GAAP. In case the accounting treatment of a transaction (occurring on or after the date of transition to Ind ASs) under the previous GAAP was different from the treatment thereof required under Ind ASs, the comparative amounts to be presented in the first Ind AS financial statements also need to be restated as to conform to accounting required under Ind ASs.

As the demerger occurred after the date of Company A’s transition to Ind ASs, it should be accounted for as per the relevant requirements of Ind ASs. As per the query, from the perspective of Company A, the demerger qualifies as a common control business combination within the meaning of this term under Appendix C of Ind AS 103. Accordingly, in the financial statements of

Company A for the comparative year 2016-17, the demerger would need to be accounted for as per the 'pooling of interest method' laid down in Appendix C of Ind AS 103. This would involve, *inter alia*, recognition of assets and liabilities of the acquired business at their respective book values as appearing in the books of Company B. This implies that the figures at which the assets and liabilities of the demerged business were recognised by Company A in its financial statements for the year 2016-17 prepared as per previous GAAP demerger would need to be restated as per the 'pooling of interests method' when presenting the comparative amounts in the Ind AS financial statements of Company A for the financial year 2017-18. 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 (1 April 2016) in the financial statements, irrespective of the actual date of the combination. This is on the basis of assumption that the acquirer and acquiree both were under common control on 1 April 2016.

Scenario B: Accounting treatment of demerger prescribed in the court-approved scheme

An announcement of the Council of the institute of Chartered Accountants of India, "Disclosures in cases where a Court/Tribunal makes an order sanctioning an accounting treatment which is different from that prescribed by an Accounting Standard¹, states that-

"..... if an item in the financial statements of a Company is treated differently pursuant to an Order made by the Court/Tribunal, as compared to the treatment required by an Accounting Standard, following disclosures should be made in the financial statements of the year in which different treatment has been given:

1. A description of the accounting treatment made along with the reason that the same has been adopted because of the Court/ Tribunal Order.
2. Description of the difference between the accounting treatment prescribed in the Accounting Standard and that followed by the Company.
3. The financial impact, if any, arising due to such a difference.

....."

¹Published in 'The Chartered Accountant', December 2004 (pp. 825)

Thus, as per the above announcement, accounting treatment of a transaction as required under an order of a court or tribunal (or other similar authority) overrides the accounting treatment that would otherwise be required to be followed in respect of the transaction and it is mandatory for the company concerned to follow the treatment as per the order of the court/tribunal.

In the context of the above requirement, if the court-approved scheme of demerger prescribed the accounting treatment for the demerger in the books of Company A (e.g., recognition of assets and liabilities acquired at their respective fair values as at the date of demerger) then Company A will follow the treatment prescribed in the scheme in its financial statements for the year 2016-17 and if the effect of such treatment is to be carried over in subsequent years also then the same treatment of court approved scheme will be followed in the subsequent years subject to compliance of auditing standards. It is to be noted that the Company A is required to follow the accounting requirements of Ind AS which are not in conflict with provisions of the court scheme.

(ITFG Clarification Bulletin 16, Issue 5)
(Date of finalisation: September 04, 2018)

Ind AS 107, Financial Instruments: Disclosures

Recognition of the dividend income on an investment in debt instrument in the books of an investor

Issue 56: How should the dividend income on an investment in debt instrument be recognised in the books of an investor?

Response: The dividend income on an investment in debt instrument shall be recognised in the form of interest. The recognition of income will depend on the category of investment in debt instrument (e.g. amortised cost, fair value through other comprehensive income or fair value through profit or loss) determined as per the requirements of Ind AS 109.

Recognition of interest income in case of investment in debt instrument measured at amortised cost

If the financial asset is measured at amortised cost, then interest revenue on the same shall be calculated using effective interest rate method in accordance with the following paragraph of Ind AS 109:

“5.4.1 Interest revenue shall be calculated by using the effective interest method (see Appendix A and paragraphs B5.4.1–B5.4.7). This shall be calculated by applying the effective interest rate to the gross carrying amount of a financial asset except for:

- (a) purchased or originated credit-impaired financial assets. For those financial assets, the entity shall apply the credit adjusted effective interest rate to the amortised cost of the financial asset from initial recognition.*
- (b) financial assets that are not purchased or originated credit impaired financial assets but subsequently have become credit-impaired financial assets. For those financial assets, the entity shall apply the effective interest rate to the amortised cost of the financial asset in subsequent reporting periods.*

5.4.2 An entity that, in a reporting period, calculates interest revenue by applying the effective interest method to the amortised cost of a financial asset in accordance with paragraph 5.4.1(b), shall, in subsequent reporting

periods, calculate the interest revenue by applying the effective interest rate to the gross carrying amount if the credit risk on the financial instrument improves so that the financial asset is no longer credit-impaired and the improvement can be related objectively to an event occurring after the requirements in paragraph 5.4.1(b) were applied (such as an improvement in the borrower's credit rating)."

Recognition of interest income in case of investment in debt instrument measured at fair value through Other Comprehensive Income

Paragraph 5.7.10 and 5.7.11 of Ind AS 109 states as follows:

5.7.10 A gain or loss on a financial asset measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A shall be recognised in other comprehensive income, except for impairment gains or losses (see Section 5.5) and foreign exchange gains and losses (see paragraphs B5.7.2–B5.7.2A), until the financial asset is derecognised or reclassified. When the financial asset is derecognised the cumulative gain or loss previously recognised in other comprehensive income is reclassified from equity to profit or loss as a reclassification adjustment (see Ind AS 1). If the financial asset is reclassified out of the fair value through other comprehensive income measurement category, the entity shall account for the cumulative gain or loss that was previously recognised in other comprehensive income in accordance with paragraphs 5.6.5 and 5.6.7. Interest calculated using the effective interest method is recognised in profit or loss.

5.7.11 As described in paragraph 5.7.10, if a financial asset is measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A, the amounts that are recognised in profit or loss are the same as the amounts that would have been recognised in profit or loss if the financial asset had been measured at amortised cost.

Accordingly, if a financial asset is measured at fair value through Other Comprehensive income (FVOCI) as per paragraph 4.1.2A of Ind AS 109, then interest revenue on such an asset calculated using effective interest rate method is recognised in profit or loss.

Recognition of interest income in case of investment in debt instrument measured at fair value through profit or loss

Paragraph B5 (e) of Ind AS 107, *Financial Instruments: Disclosures, inter alia*, provides as follows:

“B5 Paragraph 21 requires disclosure of the measurement basis (or bases) used in preparing the financial statements and the other accounting policies used that are relevant to an understanding of the financial statements. For financial instruments, such disclosure may include:

(a)

(e) how net gains or net losses on each category of financial instrument are determined (see paragraph 20(a)), for example, whether the net gains or net losses on items at fair value through profit or loss include interest or dividend income.”

Accordingly, the interest income in case of investment in debt instrument can either form part of fair value gains or losses arising from changes in fair value of the instrument or can be separately presented. In accordance with paragraph B5(e) of Ind AS 107, the entity shall disclose its accounting policy.

It may also be noted that in case any statute/ regulatory authority governing the entity specifically prescribes one of the above mentioned manner of the presentation, the entity should follow the same.

(ITFG Clarification Bulletin 8, Issue 9)

(Date of finalisation: May 05, 2017)

Foreign currency risk disclosure in case of option taken under paragraph D13AA of Ind AS 101

Issue 57: If a company has availed 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, then will the foreign currency risk disclosure of Ind AS 107, ***Financial Instruments: Disclosures*** apply to such exchange differences so capitalised?

Response: As per paragraph 40(a) of Ind AS 107, ***Financial Instruments: Disclosures***, amongst other disclosures, an entity is required to disclose a sensitivity analysis for each type of market risk, (which includes foreign exchange risk) as to which the entity is exposed at the end of the reporting period, showing how profit or loss and equity would have been affected by changes in the relevant risk variable that were reasonably possible at that date. If the company capitalises the exchange differences in the cost of

Ind AS 107, Financial Instruments: Disclosures

asset, then too the company is exposed to foreign currency risk exposure and there could be an indirect impact in the profit and loss or equity, for example through depreciation. Accordingly, the company should provide appropriate disclosures where applicable under Ind AS 107 even though the company has availed the option under paragraph D13AA of Ind AS 101.

(ITFG Clarification Bulletin 13, Issue 8)

(Date of finalisation: January 16, 2018)

Ind AS 108, Operating Segments

Disclosures by the entity in case it is operating into one segment

Issue 58: Paragraph 34 of Ind AS 108, *Operating Segments* requires entities to disclose information about its major customers i.e. those contributing 10% or more of its total amount of revenue. Whether such disclosure is required even in case where the company operates into only one segment?

Response: The scope paragraph of Ind AS 108, *Operating Segments*, *inter alia*, states that this Accounting Standard shall apply to companies to which Indian Accounting Standards (Ind ASs) notified under the Companies Act apply.

Further, paragraphs 32-35 of Ind AS 108 provide the entity-wide disclosures that an entity is required to disclose.

Paragraph 31 of Ind AS 108 states as follows:

“Paragraphs 32–34 apply to all entities subject to this Ind AS including those entities that have a single reportable segment. Some entities’ business activities are not organised on the basis of differences in related products and services or differences in geographical areas of operations. Such an entity’s reportable segments may report revenues from a broad range of essentially different products and services, or more than one of its reportable segments may provide essentially the same products and services. Similarly, an entity’s reportable segments may hold assets in different geographical areas and report revenues from customers in different geographical areas, or more than one of its reportable segments may operate in the same geographical area. Information required by paragraphs 32–34 shall be provided only if it is not provided as part of the reportable segment information required by this Ind AS.”

In accordance with the above, it may be noted that disclosure requirements as specified in paragraphs 32-34 of Ind AS 108 apply to all entities to which Ind AS applies including entities that have a single reportable segment.

Paragraph 34 of Ind AS 108 states as follows:

“Information about major customers

34 An entity shall provide information about the extent of its reliance on its major customers. If revenues from transactions with a single

external customer amount to 10 per cent or more of an entity's revenues, the entity shall disclose that fact, the total amount of revenues from each such customer, and the identity of the segment or segments reporting the revenues. *The entity need not disclose the identity of a major customer or the amount of revenues that each segment reports from that customer. For the purposes of this Ind AS, a group of entities known to a reporting entity to be under common control shall be considered a single customer. However, judgement is required to assess whether a government (including government agencies and similar bodies whether local, national or international) and entities known to the reporting entity to be under the control of that government are considered a single customer. In assessing this, the reporting entity shall consider the extent of economic integration between those entities."*

Accordingly, in the given case information regarding customers contributing to more than 10% of total revenue will be required to be disclosed by the company even though it is operating into a single operating segment. The entity need not disclose the identity of a major customer or customers, or the amount of revenues that each segment reports from that customer or those customers.

(ITFG Clarification Bulletin 13, Issue 3)

(Date of finalisation: January 16, 2018)

Ind AS 109, Financial Instruments

Valuation of financial guarantee contract

Issue 59: 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.

(ITFG Clarification Bulletin 12, Issue 11)

(Date of finalisation: October 23, 2017)

Accounting Treatment of financial guarantee received from the Director

Issue 60: Company A Ltd., applied for a term loan from Bank B for business purposes. As per the loan agreement, the loan required a personal guarantee of one of the directors of A Ltd. to be executed. In case of default by A Ltd, the director will be required to compensate for the loss that Bank B incurs. Mr. P, one of the director had given guarantee to the bank pursuant to which the loan was sanctioned to Company A. Company A does not pay premium or fees to its director for providing this financial guarantee.

Whether Company A is required to account for the financial guarantee received from its director?

Response: Ind AS 109 *Financial Instruments*, defines a financial guarantee contract as ‘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.'

Based on this definition, an evaluation is required to be done to ascertain whether the contract between director and Bank B qualifies as a financial guarantee contract as defined in Appendix A to Ind AS 109. In the given case, it does qualify as a financial guarantee contract as:

- the reference obligation is a debt instrument (term loan);
- the holder i.e. Bank B is compensated only for a loss that it incurs (arising on account of non-repayment); and
- the holder is not compensated for more than the actual loss incurred.

Ind AS 109 provides principles for accounting by the issuer of the guarantee. However, it does not specifically address the accounting for financial guarantees by the beneficiary. In an arm's length transaction between unrelated parties, the beneficiary of the financial guarantee would recognise the guarantee fee or premium paid as an expense.

It is also pertinent to note that the entity needs to exercise judgment in assessing the substance of the transaction taking into consideration relevant facts and circumstances, for example, whether the director is being compensated otherwise for providing guarantee. Based on such an assessment, an appropriate accounting treatment based on the principles of Ind AS should be followed.

In the given case, Company A Ltd, is the beneficiary of the financial guarantee and it does not pay a premium or fees to its director for providing this financial guarantee (subject to discussion above). Accordingly, Company A will not be required to account for such financial guarantee in its financial statements considering the unit of account as being the guaranteed loan, in which case the fair value would be expected to be the face value of the loan proceeds that the Company A received. Nonetheless, the above transaction needs to be evaluated for disclosure under paragraph 18 of Ind AS 24, *Related Party Disclosures*, which states as follows:

"If an entity has had related party transactions during the periods covered by the financial statements, it shall disclose the nature of the related party relationship as well as information about those transactions and outstanding balances, including commitments, necessary for users to understand the potential effect of the relationship on the financial statements. These disclosure requirements are in addition to those in paragraph 17. At a

minimum, disclosures shall include:

- (a) the amount of the transactions;*
- (b) the amount of outstanding balances, including commitments, and:
 - (i) their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and*
 - (ii) details of any guarantees given or received;****
- (c) provisions for doubtful debts related to the amount of outstanding balances; and*
- (d) the expense recognised during the period in respect of bad or doubtful debts due from related parties.”*

In the given case based on the limited facts provided, Company A will be required to make necessary disclosures of such financial guarantee in accordance with Ind AS 24.

(ITFG Clarification Bulletin 13, Issue 2)

(Date of finalisation: January 16, 2018)

Recognition of renegotiation gain/loss on Financial Instruments done in subsequent year but before the approval of financial statements

Issue 61: Ind AS 109, *Financial Instruments* requires recognition of renegotiation gain/loss subject to fulfillment of certain conditions as mentioned in the standard. If there has been a renegotiation of terms of (defaulted) borrowings subsequent to the year end, but before the date of approval of financial statements, then should such modification gain/loss be recognised in the current year financial statements itself or in the next year when the terms of (defaulted) borrowings have been renegotiated in accordance with Ind AS 109?

Response: As per paragraph 5.4.3 of Ind AS 109, *Financial Instruments*, whenever contractual cash flows of a financial instrument are renegotiated or otherwise modified and the renegotiation or modification does not result in the derecognition of that financial asset in accordance with this Standard, an entity shall recalculate the gross carrying amount of the financial asset and shall recognise a modification gain or loss in profit or loss.

In accordance with the above, modification gain or loss should be recognised in profit or loss in the period in which the renegotiation has contractually taken place. Accordingly, in the given case, if the terms of the (defaulted) borrowings have been renegotiated in the next year, then the related gain/loss should also be recognised in the next year.

(ITFG Clarification Bulletin 13, Issue 6)

(Date of finalisation: January 16, 2018)

Accounting treatment of processing fees belonging to undisbursed term loan amount

Issue 62: X Ltd. is a first-time adopter of Ind AS from financial year 2016-17. It had taken 6 year term loan in April 2010 from bank and paid processing fees at the time of sanction of loan. The term loan is disbursed in different tranches from April 2010 to April 2016. On the date of transition to Ind AS, i.e. 1.4.2015, it has calculated the net present value of term loan disbursed upto 31.03.2015 by using effective interest rate and proportionate processing fees has been adjusted in disbursed amount while calculating net present value. What will be the accounting treatment of processing fees belonging to undisbursed term loan amount?

Response: Assuming that the undisbursed loan amount will be disbursed in future, the accounting treatment of the processing fees will be as follows:

Appendix A of Ind AS 109, *Financial Instruments*, defines 'Effective interest method' as follows:

*"The rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the **gross carrying amount of a financial asset** or to the **amortised cost of a financial liability**. When calculating the effective interest rate, an entity shall estimate the expected cash flows by considering all the contractual terms of the financial instrument (for example, prepayment, extension, call and similar options) but shall not consider the **expected credit losses**. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate (see paragraphs B5.4.1–B5.4.3), **transaction costs**, and all other premiums or discounts. There is a presumption that the cash flows and the expected life of a group of similar financial instruments can be estimated reliably. However, in those rare cases when it is not possible to reliably estimate the cash flows or the expected life of a financial instrument (or group of financial instruments), the entity shall*

use the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments)."

Paragraph B5.4.1 of Ind AS 109, *Financial Instruments*, states as follows:

"In applying the effective interest method, an entity identifies fees that are an integral part of the effective interest rate of a financial instrument. The description of fees for financial services may not be indicative of the nature and substance of the services provided. Fees that are an integral part of the effective interest rate of a financial instrument are treated as an adjustment to the effective interest rate, unless the financial instrument is measured at fair value, with the change in fair value being recognised in profit or loss. In those cases, the fees are recognised as revenue or expense when the instrument is initially recognised."

Further, Paragraph B5.4.2 of Ind AS 109, *inter-alia* states that, *"fees that are an integral part of the effective interest rate of a financial instrument include:*

(a) origination fees received by the entity relating to the creation or acquisition of a financial asset. Such fees may include compensation for activities such as evaluating the borrower's financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating the terms of the instrument, preparing and processing documents and closing the transaction. These fees are an integral part of generating an involvement with the resulting financial instrument."

In accordance with the above, the processing fee is an integral part of the effective interest rate of a financial instrument and shall be included while calculating the effective interest rate.

It may be noted that to the extent there is evidence that it is probable that the undisbursed term loan will be drawn down in the future the processing fee is accounted for as a transaction cost under Ind AS 109, i.e., the fee is deferred and deducted from the carrying value of the financial liabilities when the draw down occurs and considered in the effective interest rate calculations. However, if it is not probable that the undisbursed term loan will be drawn down in the future then the fees is recognised as an expense on a straight-line basis over the term of the loan.

Accordingly, in the given case, assuming that the undisbursed loan amount will be disbursed in future, the entire processing fees, i.e. processing fee pertaining to the disbursed as well as to the undisbursed loan amount will be

included, while calculating the effective interest rate of the loan at the date of transition to Ind AS and is recognised as an expense over the term of the loan.

(ITFG Clarification Bulletin 10, Issue 2)

(Date of finalisation: July 05, 2017)

Accounting Treatment of prepayment premium and processing fees of obtaining new loan to prepay old loan

Issue 63: 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.

(ITFG Clarification Bulletin 12, Issue 4)

(Date of finalisation: October 23, 2017)

Accounting of Financial Guarantee Contract - Comfort Letter

Issue 64: 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.

(ITFG Clarification Bulletin 12, Issue 3)

(Date of finalisation: October 23, 2017)

Accounting treatment of shares held as stock-in trade in accordance with Ind AS

Issue 65: A share broking company is dealing in sale/purchase of shares for its own account and therefore is having inventory of shares purchased by it for trading. The company is covered under Phase II of Ind AS roadmap. What will be the accounting treatment of such shares held as stock-in trade in accordance with Ind AS?

Response: Paragraph 2 of Ind AS 2, *Inventories*, *inter-alia*, states that this Standard applies to all inventories, except financial instruments (Ind AS 32, *Financial Instruments: Presentation* and Ind AS 109, *Financial Instruments*).

A *financial instrument* is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. Ind AS 109 applies to all types of financial instruments with certain exceptions as envisaged in paragraph 2 of Ind AS 109.

Accordingly, the principles of recognising and measuring financial instruments are governed by Ind AS 109, its presentation is governed by Ind AS 32 and disclosures about them are in Ind AS 107, *Financial Instruments: Disclosures*, even if these instruments are held as stock-in trade by a company.

Further Ind AS 101, *First-time Adoption of Indian Accounting Standards* does not provide any transitional relief from the application of the above standards. Accordingly, in the given case, the relevant requirements of Ind AS 109, Ind AS 32 and Ind AS 107 shall be applied retrospectively unless otherwise exempted under Ind AS 101.

(ITFG Clarification Bulletin 14, Issue 5)
(Date of finalisation: February 01, 2018)

Accounting treatment of the Incentive Receivable from the Government

Issue 66: MNO Ltd. has an incentive receivable in the form of sales tax refundable from the government, under a scheme of government on complying with the certain stipulated conditions. Whether such incentives receivable from government will fall under the definition of financial instruments under Ind AS 109 considering that there is no formal one to one contractual agreement between government and the company?

Response: As per Ind AS 32 *Financial Instruments, Presentation*, A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

A financial asset is any asset that is:

- (a) cash;
- (b) an equity instrument of another entity;
- (c) a contractual right:
 - (i) to receive cash or another financial asset from another entity; or
 - (ii) ...
- (d)

Paragraph 3.1.1 of Ind AS 109, *Financial Instruments*, states as follows:

An entity shall recognise a financial asset or a financial liability in its balance sheet when, and only when, the entity becomes party to the contractual

provisions of the instrument (see paragraphs B3.1.1 and B3.1.2). When an entity first recognises a financial asset, it shall classify it in accordance with paragraphs 4.1.1–4.1.5 and measure it in accordance with paragraphs 5.1.1–5.1.3. When an entity first recognises a financial liability, it shall classify it in accordance with paragraphs 4.2.1 and 4.2.2 and measure it in accordance with paragraph 5.1.1.”

As per the above, a financial instrument arises as a result of contractual obligation between the parties.

Paragraph 13 of Ind AS 32 states that, *“In this Standard, ‘contract’ and ‘contractual’ refer to an agreement between two or more parties that has clear economic consequences that the parties have little, if any, discretion to avoid, usually because the agreement is enforceable by law. Contracts, and thus financial instruments, may take a variety of forms and need not be in writing.”*

The above paragraph clarifies that contract need not be in writing only and may take various forms. In India, government does give incentives in the form of taxation benefits etc. to promote industry or for some other reasons as the case may be. Although under such schemes, there may not be a one to one agreement between the entity and the government as to the rights and obligations but there is an understanding between the government and the potential applicant/company that on complying the stipulated conditions attached to the scheme, the entity will be granted benefits of the scheme.

If in the given case, the entity has complied with the conditions attached to the scheme then it rightfully becomes entitled to the incentives attached to the scheme. Accordingly, such incentive receivable will fall under the definition of financial instruments and will be accounted for as a financial asset per Ind AS 109.

(ITFG Clarification Bulletin 15, Issue 3)

(Date of finalisation: April 04, 2018)

Discounting of Interest free refundable security deposits

Issue 67: Whether Interest free refundable security deposits (such as rent deposits paid to lessor etc.) given by an entity are required to be discounted as per the principles of Ind AS? If yes, at what rate should these be discounted?

Response: As per Ind AS 32 *Financial Instruments: Presentation*, “A financial asset is any asset that is:

- (a) cash;
- (b) an equity instrument of another entity;
- (c) a contractual right:
 - (i) to receive cash or another financial asset from another entity; or
 - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or
- (d)

In accordance with the above, refundable security deposits given by an entity is a financial instrument and should be classified as a financial asset in accordance with Ind AS 109.

As per paragraph 5.1.1 of Ind AS 109 *Financial Instruments*, At initial recognition, an entity shall measure a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

Paragraph B5.1.1 further states that, “The fair value of a financial instrument at initial recognition is normally the transaction price (i.e. the fair value of the consideration given or received, see also paragraph B5.1.2A and Ind AS113). However, if part of the consideration given or received is for something other than the financial instrument, an entity shall measure the fair value of the financial instrument. For example, the fair value of a long-term loan or receivable that carries no interest can be measured as the present value of all future cash receipts discounted using the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating. Any additional amount lent is an expense or a reduction of income unless it qualifies for recognition as some other type of asset.”

B5.1.2A The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price (ie the fair value of the consideration given or received, see also Ind AS 113). If an entity determines that the fair value at initial recognition differs from the transaction price as

mentioned in paragraph 5.1.1A, the entity shall account for that instrument at that date as follows:

- (a) at the measurement required by paragraph 5.1.1 if that fair value is evidenced by a quoted price in an active market for an identical asset or liability (ie a Level 1 input) or based on a valuation technique that uses only data from observable markets. An entity shall recognise the difference between the fair value at initial recognition and the transaction price as a gain or loss.*
- (b) in all other cases, at the measurement required by paragraph 5.1.1, adjusted to defer the difference between the fair value at initial recognition and the transaction price. After initial recognition, the entity shall recognise that deferred difference as a gain or loss only to the extent that it arises from a change in a factor (including time) that market participants would take into account when pricing the asset or liability.*

In accordance with the above, where the effect of time value of money is material, refundable security deposits should be discounted and should be shown at their present value at the time of its initial recognition. With regard to the rate at which these should be discounted then entity needs to evaluate based on its own facts and circumstances taking into account the above guidance. Further, whether the effect of the time value of money is material or not should be determined on an overall consideration of total cash flows, etc. The difference between the transaction price and fair value as determined above should be accounted in accordance with Paragraphs B 5.1.1 and B 5.1.2A. For example, in case of an interest free rent deposit paid to a lessor in respect of a non-cancellable operating lease arrangement, the above difference may be deferred as prepaid rent to be recognised as an expense over the underlying lease term in accordance with Ind AS 17.

The deposits which are contractually repayable on demand will be recognised at the transaction price on initial recognition similar to the initial recognition of demand deposit liabilities given under Ind AS 113 paragraph 47.

*(ITFG Clarification Bulletin 15, Issue 7)
(Date of finalisation: April 04, 2018)*

Accounting treatment of the financial guarantee given by a subsidiary company

Issue 68: A 100% subsidiary (S Ltd.) gives a financial guarantee to a bank in respect of a loan obtained by its parent (P Ltd.) from the said bank. No guarantee fee/commission is charged by S Ltd. from P Ltd. P Ltd. accounts for the loan in its stand-alone as well as consolidated financial statements on amortised cost basis. The following accounting issues arise in the context of application of Ind AS by S Ltd. and P Ltd.:

- (i) How will the financial guarantee be accounted for in the separate financial statements of S Ltd.? S Ltd. has accumulated losses and has not paid any dividend in the past.
- (ii) How would financial guarantee be subsequently measured in the separate financial statements of S Ltd.?
- (iii) How should the financial guarantee be accounted for in the separate financial statements of P Ltd.?

Response:

(i) The following analysis is based on the presumption that the financial guarantee given by S Ltd. (subsidiary) meets the definition of a 'financial guarantee contract' under Ind AS 109, *Financial Instruments*.

Paragraph B2.5 of Ind AS 109, *inter-alia*, states that, "If this Standard applies, paragraph 5.1.1 requires the issuer to recognise a financial guarantee contract initially at fair value. If the financial guarantee contract was issued to an unrelated party in a stand-alone arm's length transaction, its fair value at inception is likely to equal the premium received, unless there is evidence to the contrary. Subsequently, unless the financial guarantee contract was designated at inception as at fair value through profit or loss or unless paragraphs 3.2.15–3.2.23 and B3.2.12–B3.2.17 apply (when a transfer of a financial asset does not qualify for derecognition or the continuing involvement approach applies), the issuer measures it at the higher of:

- (i) the amount determined in accordance with Section 5.5; and
- (ii) the amount initially recognised less, when appropriate, the cumulative amount of income recognised in accordance with the principles of Ind

AS 18².”

As per the above paragraph, issuer of a financial guarantee is required to recognise the financial guarantee contract initially at its fair value. This requirement will also apply if the guarantee is issued by a subsidiary in respect of a loan obtained by its parent and no fee/commission is charged by the subsidiary for issuing the guarantee. Accordingly, in the given case, S Ltd. is required to initially recognise a liability (a deferred income such as ‘unearned financial guarantee commission’) in its separate financial statements.

As regards to determination of the fair value of the financial guarantee, in the absence of any specific guidance on the issue in Ind AS 109 or in any other Ind AS and considering the broad principles of Ind AS 113, *Fair Value Measurement*, the following approaches may be considered:

- One possible measure of the fair value of the financial guarantee (at initial recognition) may be the amount that an unrelated, independent third party would have charged for issuing the financial guarantee.
- Another possible approach may be to estimate the fair value of the financial guarantee as the present value of the amount by which the interest (or other similar) cash flows in respect of the loan are lower than what they would have been if the loan were an unguaranteed loan.
- Yet another possible approach may be to estimate the fair value of the financial guarantee as the present value of the probability-weighted cash flows that may arise under the guarantee (i.e. the expected value of the liability).

If applied properly, the results of the three approaches described above are generally unlikely to differ widely.

It is noted that S Ltd. has provided the financial guarantee in respect of the loan taken by P Ltd. without charging any guarantee commission (or fee or premium). The economic substance of the arrangement is that by not charging P Ltd. the fair value of the guarantee (which S Ltd. may have charged for issuing a similar guarantee in respect of a loan taken by an unrelated third party), S Ltd. has effectively made a distribution to P Ltd. In

²Ind AS 115, *Revenue from Contracts with Customers* is notified on March 31, 2018. The reference as per Ind AS 115 is as follows:

B2.5(a) (ii) the amount initially recognised less, when appropriate, the cumulative amount of income recognised in accordance with Ind AS 115

order to reflect the substance of the transaction, the debit should be made to an appropriate head under 'equity'. It would not be appropriate to debit the fair value of the guarantee to profit or loss (as if it were a non-reciprocal distribution to a third party) as it would fail to properly reflect the existence of the parent-subsidary relationship that may have caused S Ltd. not to charge the guarantee commission. Further, S Ltd. may not have issued a similar guarantee for a loan taken by an unrelated third party without charging a fair compensation.

(ii) As per Ind AS 109, after initial recognition of a financial guarantee contract by the issuer under the Standard, the issuer shall (unless paragraph 4.2.1(a) or (b) of the standard applies- *which is not the case in the situation under discussion*) 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 18³.

In general, the application of Ind AS 18 would result in the amount of unearned financial guarantee commission recognised initially being amortised over the period of the guarantee as income and consequently, the balance of the unearned financial guarantee commission would decline progressively over the period of the guarantee. However, in addition to amortising the unearned financial guarantee commission to income, at each reporting date, S Ltd. is required to compare the unamortised amount of the deferred income with the amount of loss allowance determined in respect of the guarantee as at that date in accordance with the requirements of section 5.5 of Ind AS 109. As long as the amount of loss allowance so determined is lower than the unamortised amount of the deferred income, the liability of S Ltd. in respect of the guarantee will be represented by the unamortised amount of the financial guarantee commission. However, if at a reporting date, the amount of the loss allowance determined in accordance with section 5.5 is higher than the unamortised amount of the financial guarantee

³Ind AS 115, *Revenue from Contracts with Customers* is notified on March 31, 2018. The reference as per Ind AS 115 is as follows:

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 115, Revenue from Contracts with Customers

commission as at that date, the liability in respect of the financial guarantee will have to be measured at an amount equal to the amount of the loss allowance. Accordingly, in such a case, S Ltd. will be required to recognise a further liability equal to the excess of the amount of the loss allowance over the amount of the unamortised unearned financial guarantee commission.

(iii) Ind AS 109 states that-

“B5.4.1 In applying the effective interest method, an entity identifies fees that are an integral part of the effective interest rate of a financial instrument. The description of fees for financial services may not be indicative of the nature and substance of the services provided. Fees that are an integral part of the effective interest rate of a financial instrument are treated as an adjustment to the effective interest rate, unless the financial instrument is measured at fair value, with the change in fair value being recognised in profit or loss. In those cases, the fees are recognised as revenue or expense when the instrument is initially recognised.

B5.4.2 Fees that are an integral part of the effective interest rate of a financial instrument include:

(a) origination fees received by the entity relating to the creation or acquisition of a financial asset. Such fees may include compensation for activities such as evaluating the borrower’s financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating the terms of the instrument, preparing and processing documents and closing the transaction. These fees are an integral part of generating an involvement with the resulting financial instrument.

.....

(c) 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. An entity distinguishes fees and costs that are an integral part of the effective interest rate for the financial liability from origination fees and transaction costs relating to the right to provide services, such as investment management services.”

In the present case, financial guarantee provided by S Ltd. is an integral part of the arrangement for the loan taken by P Ltd. from the bank. As per Ind AS 109, fees associated with evaluating and recording guarantees that are an integral part of generating an involvement with a financial asset or a financial

liability are taken into account in determining the effective interest rate for the financial asset/financial liability. In the given case, since the financial guarantee is an integral part of the loan taken by the P Ltd. and is not separately provided for, so in accordance with the principles of Ind AS 109, the same is required to be taken into account for calculation of the effective interest rate.

Ind AS 109 provides principles for accounting by the issuer of the guarantee. However, it does not specifically address the accounting for financial guarantees by the beneficiary. In an arm's length transaction between unrelated parties, the beneficiary of the financial guarantee would recognise the guarantee fee or premium paid as an expense.

As already clarified in ITFG Clarification Bulletin 13, Issue 2, an entity needs to exercise judgment in assessing the substance of the transaction taking into consideration relevant facts and circumstances, for example, whether any benefits are being otherwise obtained for providing guarantee. Based on such an assessment, an appropriate accounting treatment based on the principles of Ind AS should be followed.

It may be noted that in the Issue 2 of ITFG Clarification Bulletin 13, the guarantee was given by the director. The principle of attribution acquires significance in a parent – subsidiary relationship and in the given case the beneficiary should recognise the guarantee. In the case of a guarantee provided by a subsidiary in respect of the liability of a parent, even if no consideration is received by the subsidiary, it should recognise a liability in its separate financial statements for the fair value of the guarantee. Even if no payments from the parent to the subsidiary are agreed for such a guarantee, the subsidiary has provided the guarantee in its capacity as a investee and should account for the issuance of the guarantee as a distribution to the parent. Consequentially, the transaction should also be recognised by parent.

Based on the above, in the given case, P Ltd. has not paid any guarantee commission to S Ltd. As discussed earlier in the context of accounting for the financial guarantee by S Ltd. **in terms of economic substance**, the provision of guarantee by S Ltd. without charging guarantee commission is analogous to a distribution by S Ltd. to P Ltd. To reflect this substance, P Ltd. should debit the fair value of the guarantee to the carrying amount of the loan (which would have the effect of such fair value being included in determination of effective interest rate on the loan) and credit the same as discussed below:

As per Ind AS 27, *Separate Financial Statements*, in the separate financial statements of the parent, investment in the subsidiary should be accounted for at cost or in accordance with Ind AS 109. (Certain other measurement requirements under particular circumstances are not relevant for the extant case).

- (i) If the **investment in the subsidiary is accounted for at cost then**, distribution received should be credited to profit or loss. Impairment loss, if any, will be separately considered.
- (ii) If the **investment in the subsidiary is accounted for in accordance with Ind AS 109**,
 - if measured at fair value through other comprehensive income- then in accordance with B5.7.1 of Ind AS 109, distribution are recognised in profit or loss in accordance with paragraph 5.7.6 unless the distribution clearly represents a recovery of part of the cost of the investment
 - if measured at fair value through profit or loss, distribution received will be credited to profit or loss.

The above transaction also needs to be evaluated for disclosure under paragraph 18 of Ind AS 24, *Related Party Disclosures*.

As per the facts of the case, S Ltd. is in losses and has not paid any dividend to P Ltd. in the past. These limited facts do not per se impact the accounting treatment of financial guarantee given by S Ltd.

The above clarification is given only for the accounting purposes. The commercial substance of the transaction and other legal and regulatory aspects have not been considered by ITFG which may have to be evaluated on case to case basis.

(ITFG Clarification Bulletin 16, Issue 1)

(Date of finalisation: September 07, 2018)

Accounting treatment of the modification of the terms of the loan or assignment of loan to Asset Reconstruction Company (ARC)

Issue 69: DG Ltd. had taken foreign letter of credit from a scheduled bank in financial year 2011-12 at a rate linked to LIBOR (which was 4.50% at that time). DG Ltd. was unable to meet its repayment obligation on the due date and the bank crystallised the liability into INR. As the loan was not serviced by DG Ltd. it became NPA for the bank.

Thereafter, the bank assigned the loan to an Asset Reconstruction Company (ARC). The loan which was taken over by ARC was subsequently negotiated between the ARC and DG Ltd. to arrive at a settlement as part of the above assignment.

The above arrangement was agreed upon between the parties in the form of hair cut by the ARC for some balance of the loan, partial settlement of the loan by issue of fully paid up equity shares at traded market price and the balance loan amount to be paid in installments over 7 years. The revised interest agreed upon by the ARC is linked to the marginal cost of funds based lending rate (MCLR) and with certain additional discount of some basis points which is lesser than the normal bank funding rates. This arrangement between the parties was entered into post implementation date of Ind AS for the Company.

Whether the above is a modification of debt from the perspective of DG Ltd. If so, how such modification will be accounted for?

Response: In the given case, the above arrangement between ARC and DG Ltd. towards the outstanding loan has been entered during the year when Ind AS is applicable to DG Ltd. The loan taken by DG Ltd. is a 'financial liability' as defined in Ind AS 32. The timing as well as the manner of recognition of effects of the above arrangement between ARC and DG Ltd. will be governed by Ind AS 109, *Financial Instruments*.

The response in the following paragraphs is based on the assumption that the carrying amount of the loan as on to the date of transition to Ind AS and the original effective interest rate referred to in paragraph B3.3.6 of Ind AS 109 have been correctly determined by the entity in accordance with the requirements of Ind AS 109, read with Ind AS 101, *First-time Adoption of Indian Accounting Standards*.

Paragraphs 3.3.1 – 3.3.3 of Ind AS 109 provide the following guidance in this regard:

- “3.3.1 An entity shall remove a financial liability (or a part of a financial liability) from its balance sheet when, and only when, it is extinguished—ie when the obligation specified in the contract is discharged or cancelled or expires.
- 3.3.2 An exchange between an existing borrower and lender of debt instruments with substantially different terms shall be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. Similarly, a substantial

modification of the terms of an existing financial liability or a part of it (whether or not attributable to the financial difficulty of the debtor) shall be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

- 3.3.3 *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.”*

Paragraphs B3.3.1 of Ind AS 109 Appendix B states as under:

B3.3.1 A financial liability (or part of it) is extinguished when the debtor either:

- (a) discharges the liability (or part of it) by paying the creditor, normally with cash, other financial assets, goods or services; or*
- (b) is legally released from primary responsibility for the liability (or part of it) either by process of law or by the creditor. (If the debtor has given a guarantee this condition may still be met.)*

[It is assumed in the following discussion that no costs or fees have been incurred in connection with modification of the terms of the loan.]

As per paragraphs 3.3.1 and B3.3.1, DG Ltd. is required to assess that whether change of the lender (assignment of loan) from bank to the ARC is a legal release from the primary liability to the bank. If it is so concluded, then the entire amount of the existing loan will be derecognised and new arrangement with ARC shall be accounted for as a new loan and the difference shall be recognised in profit or loss.

If it is concluded that change of the lender (assignment of loan) does not result in legal release from primary liability to the bank then DG Ltd. needs to consider the requirements of paragraph 3.3.2 of Ind AS 109. As per paragraph 3.3.2, a substantial modification of the terms of an existing financial liability or a part of it (whether or not attributable to the financial difficulty of the debtor) is accounted for as an extinguishment of the original financial liability (or part of the financial liability) and the recognition of a new financial liability. For determining whether a modification of the terms of an existing financial liability (or a part of it) is substantial, paragraph B3.3.6 of Ind AS 109 Appendix B lays down a quantitative test. As per paragraph

B3.3.6, the terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10 per cent different from the discounted present value of the remaining cash flows of the original financial liability.

In case a modification of the terms of a financial liability fails to meet the 10% quantitative threshold laid down in paragraph B3.3.6, an issue arises whether it can be concluded without carrying any further analysis that the modification is not substantial. While Ind AS 109 does not provide any specific guidance on this issue, the quantitative test alone may not be sufficient to reach the above conclusion in all cases. This is because some or all of modification to the terms of a financial liability may be of such nature that their effect is not captured by the quantitative test.

Determining whether the terms are substantially different, from a qualitative perspective, is judgemental and will depend on the specific facts and circumstances of each case. Where a modification of the terms of a financial liability does not meet the quantitative threshold of 10%, a qualitative analysis may be required to be carried out to determine whether modifications of the terms that are not captured by the quantitative analysis are substantial. There may be situations where the modification of the debt is so fundamental that derecognition is appropriate whether or not the 10% test is satisfied.

It is noted that as per the terms of settlement with ARC, DG Ltd. was required to settle a part of the loan immediately by way of issue of its own equity shares at fair value. The partial settlement of the existing loan by issuing equity will be accounted for in accordance with Appendix D of Ind AS 109, *Extinguishing Financial Liabilities with Equity Instruments* and paragraph 3.3.4 of Ind AS 109.

The balance should be tested by DG Ltd. for de-recognition i.e. whether there is a substantial modification of the terms of an existing financial liability or a part of it. In the present case, as per the facts of the case, the modifications relate to terms that are captured by the quantitative test (viz. the 'haircut', rescheduling of repayment, and change in interest rate); there are no additional factors requiring a qualitative analysis in the given case. Hence, if the quantitative threshold of 10% is met, the modification should be considered to be substantial (and vice versa).

If the modification of balance loan is considered to be substantial, then DG Ltd. should de-recognises the balance loan and recognises the new modified loan and any difference between the carrying amount of the original balance loan and new modified loan is recognised in profit or loss.

(ITFG Clarification Bulletin 16, Issue 3)
(Date of finalisation: September 04, 2018)

Accounting treatment of the financial guarantee in case of repayment of the Loan before the tenure

Issue 70: S Ltd. has availed loan in financial year 2012 (no concession in rate of interest is given by bank by virtue of guarantee from parent) from banks. The said loan has been guaranteed by its Parent P Ltd). Parent is in phase -2 of implementation of Ind AS where transition date is 1st April 2016. S Ltd. is 61.5% subsidiary of P Ltd. Initial estimate/tenure of the borrowing was 10 years. However, the S Ltd. repaid the whole loan amount within the period of 6 years in financial year 2018. On transition date, P Ltd. recognised the financial liability obligation in its separate financial statements and presented resultant 'Investment in subsidiary' to that extent.

What shall be the accounting treatment of the 'financial guarantee' provided by the P Ltd. in respect of loan/borrowing availed by S Ltd., in case the underlying loan is repaid earlier than estimated initially?

Response: As per the requirements of Ind AS 109 *Financial Instruments*, on the date of transition, P Ltd. recognised the 'Financial guarantee obligation' in its separate financial statement with the corresponding impact in the 'Investment in subsidiary' on initial recognition after considering the terms of the guarantee.

With regard to subsequent measurement, as stated in Issue 1, financial guarantee contract is subsequently measured at the higher of: (i) the amount of the loss allowance and (ii) the amount initially recognised less, when appropriate, the cumulative amount of income recognised in accordance with the principles of Ind AS 18⁴.

⁴Ind AS 115, *Revenue from Contracts with Customers* is notified on March 31, 2018 and superseded Ind AS 11 and Ind AS 18.

As per the facts in the given case, the parent company initially recognised the financial guarantee obligation at its fair value, based on the estimated term of the loan/borrowing as 10 years but, S Ltd. repaid the entire amount of loan after the expiry of 6 years.

There is a change in the expected tenure in terms of contractual life which was earlier estimated for 10 years while the actual tenure came out to be 6 year. With regard to change in estimate with respect to the tenure of the instrument, guidance given under Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors* may be considered.

Paragraph 36 and 37 of Ind AS 8 states as follows:

“36 The effect of change in an accounting estimate, other than a change to which paragraph 37 applies, shall be recognised prospectively by including it in profit or loss in:

- (a) the period of the change, if the change affects that period only; or*
- (b) the period of the change and future periods, if the change affects both.*

37 To the extent that a change in an accounting estimate gives rise to changes in assets and liabilities, or relates to an item of equity, it shall be recognised by adjusting the carrying amount of the related asset, liability or equity item in the period of the change.”

In accordance with the above, it may be noted that where change in the accounting estimate gives rise to changes in assets, liabilities and equity, then the same shall be adjusted in the carrying amount of the related asset, liability or equity item in the period of the change. As per the facts mentioned above, there is change in the estimate of expected life of the instrument (i.e. loan is repaid in 6 year rather than repaying it after 10 years) and since no obligation exists for parent in respect of the financial guarantee provided by the parent, the parent may reverse the amount of obligation.

The attribution debited to investment upon providing guarantee is in substance the consideration that the parent would have collected for providing similar guarantee to an unrelated third party. In case of prepayment of loan by an unrelated third party, the parent would generally not have refunded the consideration and would have recognised the entire unrecognised commission in profit & loss. Similar approach should be followed for guarantee given to the subsidiary.

Accordingly, in the given case, on initial recognition P Ltd. recognised a

financial guarantee obligation of ₹ 1000. As required by paragraph 4.2.1(c)(ii) of Ind AS 109, this amount initially recognised is amortised as income in each accounting period. By the end of the year 6, ₹ 400 is standing as carrying value of financial guarantee in the financial statement of P Ltd. But since S Ltd. has repaid the loan, there is no obligation existing for P Ltd. Accordingly, P Ltd. should reverse the balance outstanding as guarantee obligation with corresponding recognition of revenue of ₹ 400 in profit and loss account.

(ITFG Clarification Bulletin 16, Issue 7)

(Date of finalisation: September 04, 2018)

Accounting Treatment of Dividend Distribution Tax (DDT) in calculating effective interest rate (EIR) on the preference shares

Issue 71: During its current financial year, ABC Ltd. has issued cumulative redeemable preference shares which carry a dividend of 10% per annum. The preference shares are redeemable at a specified premium at the end of 8 years from the date of their issue. On a consideration of the substance of the terms and conditions of issue of the preference shares, including the stipulations as to dividends and premium payable on redemption, ABC Ltd has determined that the preference shares qualify for classification as a financial liability in their entirety under Ind AS 32, *Financial Instruments: Presentation*.

ABC Ltd is a 'domestic company' within the meaning of this term under the Income-tax Act 1961 ('the Act'). Accordingly, dividend on the preference shares (within the meaning of the term 'dividend' under section 2(22) of the Act) is subject to provisions relating to Dividend Distribution Tax (DDT) contained in section 115-O of the Act.

In accounting for the preference shares in accordance with Ind AS 109, would DDT be included in calculating effective interest rate (EIR) on the preference shares?

Response: With regard to the treatment of 'dividend' on a financial instrument, paragraphs 35 and 36 of Ind AS 32, *Financial Instruments Presentation* reproduced hereunder may be noted:

“35 Interest, dividends, losses and gains relating to a financial instrument or a component that is a financial liability shall be recognised as income or expense in profit or loss. Distributions to holders of an equity instrument

shall be recognised by the entity directly in equity. Transaction costs of an equity transaction shall be accounted for as a deduction from equity.

- 36 *The classification of a financial instrument as a financial liability or an equity instrument determines whether interest, dividends, losses and gains relating to that instrument are recognised as income or expense in profit or loss. Thus, dividend payments on shares wholly recognised as liabilities are recognised as expenses in the same way as interest on a bond. Similarly, gains and losses associated with redemptions or refinancings of financial liabilities are recognised in profit or loss, whereas redemptions or refinancings of equity instruments are recognised as changes in equity. Changes in the fair value of an equity instrument are not recognised in the financial statements.”*

In view of the above, if a financial instrument is classified as financial liability in its entirety (as is the position in the case under discussion), the ‘dividend’ thereon is in the nature of interest and is accordingly charged to profit or loss.

Further, paragraphs B5.4.4 and B5.4.8 of Ind AS 109, *Financial Instruments*, state as follows:

“B5.4.4 When applying the effective interest method, an entity generally amortises any fees, points paid or received, transaction costs and other premiums or discounts that are included in the calculation of the effective interest rate over the expected life of the financial instrument.....”

The Guidance Note on Division II - Ind AS Schedule III to the Companies Act, 2013 issued by of the Institute of Chartered Accountants of India provides the following guidance in respect of dividend on preference shares:

“Dividend on preferences shares, whether redeemable or convertible, is of the nature of ‘Interest expense’, only where there is no discretion of the issuer over the payment of such dividends. In such case, the portion of dividend as determined by applying the effective interest method should be presented as ‘Interest expense’ under ‘Finance cost’. Accordingly, the corresponding Dividend Distribution Tax on such portion of non-discretionary dividends should also be presented in the Statement of Profit and Loss under ‘Interest expense’.

Furthermore, FAQ regarding DDT issued by the Accounting Standards Board of the Institute of Chartered Accountants of India *inter-alia* states that, “presentation of DDT paid on the dividends should be consistent with the

presentation of the transaction that creates those income tax consequences. Therefore, DDT should be charged to profit or loss, if the dividend itself is charged to profit or loss. If the dividend is recognised in equity, the presentation of DDT should be consistent with the presentation of the dividend, i.e., to be recognised in equity.”

In the given case, the preference shares are classified as a liability in their entirety and ‘dividend’ thereon is therefore considered to be in the nature of interest. Accordingly, the related dividend distribution tax should be regarded as part of interest cost and should therefore form part of EIR calculation.

(ITFG Clarification Bulletin 17, Issue 2)

(Date of finalisation: December 19, 2018)

Recognition of dividend income on an investment on a debt instrument in the books of the investor

Issue 72: How should ‘dividend income’ on an investment on a debt instrument be recognised in the books of the investor?

Response: Issue 9 in ITFG Clarification Bulletin 8 deals with a situation where the legal form of income received by an investor on an investment in a financial instrument is that of ‘dividend’:

In the said clarification it is stated that the recognition of income will depend on the classification of the instrument as FVTPL (at fair value through profit or loss), amortised cost or FVOCI (at fair value through other comprehensive income) as determined in accordance with the requirements of Ind AS 109, *Financial Instruments*.

The following further clarification on the issue may be noted.

Under Ind AS 109, a financial asset cannot be classified under ‘amortised cost’ or ‘FVOCI (debt)’ category if it does not meet the following conditions:

- (i) Business Model Test; and
- (ii) Contractual Cash flow Characteristic test (SPPI test).

If the SPPI test is met, the issue whether the financial asset would be classified under ‘amortised cost’ category or under ‘FVOCI (debt)’ category is also determined by considering the business model within which the financial asset is held.

Paragraph B4.1.7A of Ind AS 109 provides guidance on the SPPI test and states as below:

*“Contractual cash flows that are solely payments of principal and interest on the principal amount outstanding are consistent with a basic lending arrangement. In a basic lending arrangement, consideration for the **time value of money** (see paragraphs B4.1.9A–B4.1.9E) and **credit risk** are typically the most significant elements of interest. However, in such an arrangement, interest can also include consideration for other basic lending risks (for example, liquidity risk) and costs (for example, administrative costs) associated with holding the financial asset for a particular period of time. In addition, interest can include a profit margin that is consistent with a basic lending arrangement. In extreme economic circumstances, interest can be negative if, for example, the holder of a financial asset either explicitly or implicitly pays for the deposit of its money for a particular period of time (and that fee exceeds the consideration that the holder receives for the time value of money, credit risk and other basic lending risks and costs). However, contractual terms that introduce exposure to risks or volatility in the contractual cash flows that is unrelated to a basic lending arrangement, such as **exposure to changes in equity prices or commodity prices, do not give rise to contractual cash flows** that are solely payments of principal and interest on the principal amount outstanding. An originated or a purchased financial asset can be a basic lending arrangement irrespective of whether it is a loan in its legal form.”*

An example of a debt instrument having legal form of income as dividend is redeemable preference share. In the case of a redeemable preference share, the issue whether the SPPI test is met or not requires consideration of whether payment of dividend on the preference share is non-discretionary (i.e., obligatory) or at the discretion of the issuer. Where payment of dividend is not at the discretion of the issuer, the contractual cash flows (dividends and redemption proceeds) associated with the preference share would be akin to those associated with a plain-vanilla loan or other plain-vanilla debt instrument unless the cash flows do not meet the SPPI test mentioned in previous paragraphs. On the other hand, where the payment of dividend on the preference share, whether cumulative or non-cumulative, is at the discretion of the issuer, the contractual cash flows characteristics in such cases differ from those of a basic lending arrangement inasmuch as interest is also a contractual flow in a basic lending arrangement. Accordingly, a preference share with a discretionary dividend feature cannot be said to represent a basic lending arrangement. Hence, such a preference shares fails the SPPI test and cannot therefore be classified as at amortised cost or FVOCI. The appropriate classification of such preference share is

therefore as at FVTPL.

Determining whether or not the payment of dividend on a preference share is at the discretion of the issuer requires consideration of applicable legal provisions in the relevant jurisdiction and also the specific terms and conditions associated with the preference share.

If the preference shares meet the SPPI test and business model test then the dividend income will be accounted for using effective interest rate method provided the instrument is classified under either at amortised cost or FVOCI. If it does not meet above tests or the entity has chosen the fair value option, the instrument will be classified at FVTPL and the entity will give disclosures for its accounting policy in accordance with paragraph B5 (e) of Ind AS 107, *Financial Instruments: Disclosures*.

(ITFG Clarification Bulletin 17, Issue 4)
(Date of finalisation: December 19, 2018)

Ind AS 110, Consolidated Financial Statements

Accounting Treatment of loss of investment in subsidiary

Issue 73: Parent had 70% stake in subsidiary. The other investor invested additional funds in the subsidiary reducing the parent's stake to 60%. However, there was no loss of control by the Parent. How this partial deemed disposal should be accounted in the separate financial statements of the parent assuming that investment in subsidiary is measured at cost. Also, state the accounting treatment in the consolidated financial statements?

Response: Treatment in Separate Financial Statements of the Parent entity

In the given case, in the separate financial statements of the parent entity there will not be any impact and investment in the subsidiary will continue to be recognised at its carrying amount. However, the fact that its shareholding has been reduced from 70% to 60% should be disclosed appropriately in the financial statements.

Treatment in Consolidated Financial Statements

As per paragraph 23 of Ind AS 110 *Consolidated Financial Statements*, changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions (i.e. transactions with owners in their capacity as owners).

Thus, such transactions have no impact on goodwill or the statement of profit and loss.

Paragraph B96 of Appendix B to Ind AS 110 further provides that, when the proportion of the equity held by non-controlling interests changes, an entity shall adjust the carrying amounts of the controlling and non-controlling interests to reflect the changes in their relative interests in the subsidiary. The entity shall recognise directly in equity any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received, and attribute it to the owners of the parent.

Non-controlling interests (NCI) are recorded at fair value (or proportionate share in the recognised amounts of the acquiree's identifiable net assets, if

chosen) only at the date of the business combination. Subsequent purchases or sales of ownership interests when control is maintained are recorded at the non-controlling interest's proportionate share of the net assets.

As per paragraph 18 of Ind AS 112, *Disclosure of Interests in Other Entities*, an entity is required to present a schedule that shows the effects on the equity attributable to owners of the parent of any changes in its ownership interest in a subsidiary that do not result in a loss of control.

(ITFG Clarification Bulletin 13, Issue 7)

(Date of finalisation: January 16, 2018)

Accounting treatment of dividend distribution tax in the consolidated financial statements in case of partly-owned subsidiary - different scenarios

Issue 74: What will be the accounting treatment of dividend distribution tax in the consolidated financial statements in case of partly-owned subsidiary in the following scenarios:

Scenario 1: H Limited (holding company) holds 12,000 equity shares in S Limited (Subsidiary of H Limited) with 60% holding. Accordingly, S Limited is a partly-owned subsidiary of H Limited. During the year 2017, S Limited paid a dividend @ ₹ 10 per share, amounting to ₹ 200,000 and DDT @ 20% amounting to ₹ 40,000.

Should the share of H Limited in DDT paid by S Limited amounting to ₹ 24,000 (60% of ₹ 40,000) be charged as expense in the consolidated profit and loss of H Limited?

Response: Since H Limited is holding 12,000 shares it has got ₹ 1,20,000 as dividend from S Limited. In the consolidated financial statements of H Ltd., dividend income earned by H Ltd. and dividend recorded by S Ltd. in its equity will both get eliminated as a result of consolidation adjustments. Dividend paid by S Ltd. to the 40% non-controlling interest (NCI) shareholders will be recorded in the Statement of Changes in Equity as reduction of NCI balance (as shares are classified as equity as per Ind AS 32).

DDT of ₹ 40,000 paid to tax authorities has two components- One ₹ 24,000 (related to H Limited's shareholding and other ₹ 16,000 belong to non-controlling interest (NCI) shareholders of S Limited). DDT of ₹ 16,000 (pertaining to non-controlling interest (NCI) shareholders) will be recorded in the Statement of Changes in Equity along with dividend. DDT of ₹ 24,000

paid outside the consolidated Group shall be charged as tax expense in the consolidated statement of profit and loss of H Ltd.

It may be noted that Issue 1 of ITFG Clarification Bulletin 9 provides that-

“In the consolidated financial statements of P Ltd., the dividend income earned by P Ltd. from S Ltd. and dividend recorded by S Ltd. in its equity will both get eliminated as a result of consolidation adjustments. DDT of ₹ 20,000 paid outside the consolidated Group i.e. to the tax authorities should be charged as expense in the consolidated statement of Profit and Loss of P Ltd.”

The similar accounting treatment would be done in case of the partly-owned subsidiary:

In accordance with the above, in the given case, CFS of H limited will be as under:

Transactions	H Ltd.	S Ltd.	Consol Adjustments	CFS H Ltd
Dividend Income (P&L)	120,000	-	(120,000)	-
Dividend (in Statement of Changes in Equity by way of reduction of NCI)	-	(200,000)	120,000	(80,000)
DDT (in Statement of Changes in Equity by way of reduction of NCI)	-	(40,000)	24,000	(16,000)
DDT (in Statement of P&L)	-	-	(24,000)	(24,000)

Scenario 2 (A): Extending the situation given in scenario 1, H Limited also pays dividend of ₹ 300,000 to its shareholders and DDT liability @ 20% thereon amounts to ₹ 60,000. As per the tax laws, DDT paid by S Ltd. of ₹ 24,000 is allowed as set off against the DDT liability of H Ltd., resulting in H Ltd. paying ₹ 36,000 (₹ 60,000 – ₹ 24,000) as DDT to tax authorities.

Response: If DDT paid by the subsidiary S Ltd. is allowed as a set off against the DDT liability of its parent H Ltd. (as per the tax laws), then the amount of such DDT should be recognised in the consolidated statement of changes in equity of parent H Ltd.

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In the given case, share of H Limited in DDT paid by S Limited is ₹ 24,000 and entire ₹ 24,000 was utilised by H Limited while paying dividend to its own shareholders.

Accordingly, DDT of ₹ 76,000 (₹ 40,000 of DDT paid by S Ltd. (of which ₹ 16,000 is attributable to NCI) and ₹ 36,000 of DDT paid by H Ltd.) should be recognised in the consolidated statement of changes in equity of parent H Ltd. No amount will be charged to consolidated statement of profit and loss. The basis for such accounting would be that due to Parent H Ltd's transaction of distributing dividend to its shareholders (a transaction recorded in Parent H Ltd's equity) and the related DDT set-off, this DDT paid by the subsidiary is effectively a tax on distribution of dividend to the shareholders of the parent company.

In accordance with the above, in the given case, CFS of H limited will be as under:

Transactions	H Ltd	S Ltd	Consol Adjustments	CFS H Ltd
Dividend Income (P&L)	120,000	-	(120,000)	-
Dividend (in Statement of Changes in Equity)	(300,000)	(200,000)	120,000	(380,000)*
DDT (in Statement of Changes in Equity)	(36,000)	(40,000)	-	(76,000)*

*Dividend of ₹ 80,000 and DDT of ₹ 16,000 will be reflected as reduction from non-controlling interest.

(B) If in (A) above, H Limited pays dividend amounting to ₹ 100,000 with DDT liability @ 20% amounting to ₹ 20,000.

Response: In the given case, share of H Limited in DDT paid by S Limited is ₹ 24,000 out of which only ₹ 20,000 was utilised by H Limited while paying dividend by its own. Therefore, balance ₹ 4,000 should be charged in the consolidated statement of profit and loss.

In accordance with the above, in the given case, CFS of H limited will be as under:

Ind AS 110, Consolidated Financial Statements

Transactions	H Ltd	S Ltd	Consol Adjustments	CFS H Ltd
Dividend Income (P&L)	120,000	-	(120,000)	-
Dividend (in Statement of Changes in Equity)	(100,000)	(200,000)	120,000	(180,000)*
DDT (in Statement of Changes in Equity)	-	(40,000)	4,000	(36,000)*
DDT(in Statement of P&L)	-	-	(4000)	(4000)

*Dividend of ` 80,000 and DDT of ` 16,000 will be reflected as reduction from non- controlling interest.

Scenario (3): Will the answer be different for the treatment of dividend distribution tax paid by associate in the consolidated financial statement of investor, if as per tax laws the DDT paid by associate is not allowed set-off against the DDT liability of the investor?

Response: Considering that as per tax laws, DDT paid by associate is not allowed set off against the DDT liability of the investor, the investor's share of DDT would be accounted by the investor company by crediting its investment account in the associate and recording a corresponding debit adjustment towards its share of profit or loss of the associate.

(ITFG Clarification Bulletin 13, Issue 9)

(Date of finalisation: January 16, 2018)

Treatment of depreciation in consolidated financial statements when different method of depreciation applied by entities

Issue 75: PQR Ltd. is the subsidiary company of MNC Ltd. In the stand-alone financial statements prepared in accordance with Ind AS, PQR Ltd. has adopted Straight-line method (SLM) of depreciation and MNC Ltd. has adopted Written-down value method (WDV) for depreciating its property, plant and equipment. As per Ind AS 110, *Consolidated Financial Statements*, a parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances.

How will these property, plant and equipment be depreciated in the consolidated financial statements of MNC Ltd. prepared as per Ind AS?

Response: Paragraph 19 and paragraph B87 of Ind AS 110, *Consolidated Financial Statements*, states as follows:

“19 A parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances.

B87 If a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to that group member’s financial statements in preparing the consolidated financial statements to ensure conformity with the group’s accounting policies.”

It may be noted that the above mentioned paragraphs require an entity to apply uniform accounting policies for like transactions and events in similar circumstances. It does not apply to accounting estimates made while preparing financial statements.

Further, paragraphs 60 & 61 of Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, state as follows:

“60 The depreciation method used shall reflect the pattern in which the asset’s future economic benefits are expected to be consumed by the entity.

*61 The depreciation method applied to an asset shall be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method shall be changed to reflect the changed pattern. **Such a change shall be accounted for as a change in an accounting estimate in accordance with Ind AS 8.**”(Emphasis added)*

In accordance with the above, it may be noted that the selection of the method of depreciation is an accounting estimate and not an accounting policy.

Accordingly, the entity should select the method that most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. That method should be applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits in separate financial statements as well as consolidated financial statements.

Therefore, there can be different methods of estimating depreciation for property, plant and equipment, if their expected pattern of consumption is different. The method once selected in the stand-alone financial statements of the subsidiary should not be changed while preparing the consolidated financial statements.

Accordingly, in the given case, the property, plant and equipment of PQR Ltd. (subsidiary company) may be depreciated using straight line method and property, plant and equipment of parent company (MNC Ltd.) may be depreciated using written down value method, if such method closely reflects the expected pattern of consumption of future economic benefits embodied in the respective assets.

(ITFG Clarification Bulletin 11, Issue 6)

(Date of finalisation: July 31, 2017)

Accounting treatment of the outstanding retired partners' capital balances

Issue 76: A Company has investment in a partnership firm and it has established that it has control over the firm as per the requirements of Ind AS 110, *Consolidated Financial Statements*. Accordingly, as per Ind AS, the company is required to consolidate the firm as its subsidiary and its financial statement is required to be in compliance with Ind AS. There are amounts outstanding towards retired partners' capitals, which are repayable by the partnership firm on demand. What would be the accounting treatment of these outstanding retired partners' capital balances? Whether these are required to be discounted?

Response: In the given case, since the company has assessed and established control over the partnership firm as per Ind AS 110, accordingly, it will be required to consolidate the partnership firm as per the requirements of Ind AS. Though Ind AS would not be applicable to the partnership firm nevertheless its financial statements to be consolidated by the company is required to be in compliance with Ind AS.

In the given case, since the amounts outstanding towards retired partners' capitals can be demanded by those retired partners anytime and it meets the definition of a financial liability under Ind AS 32(i.e. it is firm's contractual obligation to deliver cash or another financial asset), accordingly, the same shall be measured at its fair value.

Paragraph 47 of Ind AS 113 states that 'the fair value of a financial liability

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with a demand feature is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.'

Accordingly, in the given case based on the facts provided these amounts are considered as repayable on demand at any time, and therefore, no discounting would be required on initial recognition and subsequent measurement.

(ITFG Clarification Bulletin 15, Issue 9)

(Date of finalisation: April; 04, 2018)

Ind AS 7, Statement of Cash Flows

Classification of investments made by an entity in units of money-market mutual funds

Issue 77 : Whether investments made by an entity in units of money-market mutual funds (i.e., those investing in money-market instruments such as treasury bills, certificates of deposit and commercial paper) that are traded in an active market or are puttable by the holder to the fund at net asset value (NAV) at any time can be classified as cash equivalents as per Ind AS?

Response: Paragraph 6 of Ind AS7, *Statement of Cash Flows*, defines the term “cash equivalents” as follows:

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

Further paragraph 7 of Ind AS 7, *inter-alia* states that, “Cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes. For an investment to qualify as a cash equivalent it must be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value.”

As per the above, Ind AS 7 prescribes the following three cumulative conditions to be met for an investment to be classified as a ‘cash equivalent’ under the standard:

- (a) The investment must be for meeting short-term cash commitments.
- (b) It must be highly liquid, i.e. readily convertible to cash.
- (c) The amount that would be realised from the investment must be known, with no more than an insignificant risk of change in value of the investment.

The investment must be for meeting short-term cash commitments

Whether an investment is for meeting short-term cash commitments or not is essentially a matter of management intent which can generally be inferred

from such documentary sources as investment policy, investment manuals, minutes of relevant committee meetings, etc. and can be corroborated by the actual experience of buying and selling those investments. However, it is to be noted that such investments are to be held only as a means of settling liabilities, and not as an investment or for any other purposes. Therefore, whether this condition is met or not requires an assessment of the particular facts and circumstances of a case.

Investment must be highly liquid, i.e. readily convertible to cash.

Units of a money market mutual fund that are traded in an active market or that can be put back by the holder at any time to the fund at their net asset value may meet the condition of the investment being highly liquid.

The amount that would be realised from the investment must be known, with no more than an insignificant risk of change in value of the investment.

It is pertinent to note that the amount of cash that will be received must be known at the time of the initial investment. Accordingly, the investments in units of money market funds cannot be considered cash equivalents simply because they can be converted to cash at any time at the then market price in an active market. Further, the entity would have to satisfy itself that the investment is subject to an insignificant risk of changes in value for it to be classified as a cash equivalent. Hence, the purpose of holding the instrument and the satisfaction of the criteria should both be clear from its terms and conditions.

Accordingly, it requires careful assessment of each of the investments of the entity considering the definition given under Ind AS 7 as well as the purpose of holding the investments. An entity should satisfy itself and able to demonstrate that the investment is subject to an insignificant risk of change in value for it to be classified as a cash equivalent.

As a general proposition, the third condition, viz. that the investment must be convertible into a known amount of cash and the risk of change in the value of the investment should not be more than insignificant is usually not expected to be met by units of a money-market (or other) mutual fund which can be put back by the holder to the fund at any time for redemption at net asset value (or can be sold in an active market). It is well-known that even though the money market instruments have a relatively short life, their value keeps changing primarily due to changes in interest rates. Consequently, the amount of cash that will be received from redemption or sale of the units may not be known at the time of the initial investment and the value of such units

may be subject to a more than insignificant risk of change during the period of their holding. However, there may be cases wherein this condition is met e.g. where such units are acquired only for a very brief period before the end of tenure of a mutual fund and the maturity amounts of the fund's investments are pre-determined and known – in such a case, it might be possible to argue that the redemption amount of the units is known and subject only to an insignificant change in value.

(ITFG Clarification Bulletin 16, Issue 4)
(Date of finalisation: September 04, 2018)

Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors

Disclosure of the new Ind AS which is not yet effective (Ind AS 115)

Issue 78: Whether an entity is required to disclose the impact of Ind AS 115, *Revenue from Contracts with Customers* (as required by paragraph 30 of Ind AS 8) in its financial statements as prepared as per Ind AS?

Response: Paragraph 30 of Ind AS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, states as follows:

“When an entity has not applied a new Ind AS that has been issued but is not yet effective, the entity shall disclose:

- (a) this fact; and*
- (b) known or reasonably estimable information relevant to assessing the possible impact that application of the new Ind AS will have on the entity’s financial statements in the period of initial application.”*

In accordance with the above, it may be noted that an entity is required to disclose the impact of Ind AS which has been issued but is not yet effective.

However, it may be noted that Ind AS 115, which was earlier notified under Companies (Indian Accounting Standards) Rules, 2015, vide MCA notification dated February 16, 2015 stands withdrawn under Companies (Indian Accounting Standards) (Amendments) Rules, 2016 vide MCA notification dated March 30, 2016. Accordingly, an entity is not required to disclose the impact of Ind AS 115 for the financial year ending March 31, 2017 as Ind AS 115 has been omitted from the Rules.

(ITFG Clarification Bulletin 8, Issue 2)
(Date of finalisation: May 05, 2017)

Ind AS 12, Income Taxes

Accounting treatment of Tax Holidays under Ind AS

Issue 79: Under the previous GAAP, ASI 3, *Accounting for Taxes on Income in the situations of Tax Holiday under Sections 80-IA and 80-IB of the Income-tax Act, 1961* and ASI 6 *Accounting for Taxes on Income in the context of Section 115JB of the Income-tax Act, 1961* provides guidance on how AS 22, *Accounting for Taxes on Income* is to be applied in the situations of tax holiday under section 80-IA and 80-IB of the Act.

Whether the same treatment can be applied under Ind AS?

Response: The consensus portion of ASI 3, *Accounting for Taxes on Income in the situations of Tax Holiday under Sections 80-IA and 80-IB of the Income-tax Act, 1961*, was included as 'Explanation' to the paragraph 13 of Accounting Standard (AS) 22, *Accounting for Taxes on Income*, notified under the Companies (Accounting Standards) Rules, 2006. Accordingly, it became the part of notified Accounting Standards. The ASIs are also not effective in context of Indian Accounting Standards notified under Companies (Indian Accounting Standards) Rules, 2015.

However, under Ind AS, the principles enunciated in Ind AS 12, *Income Taxes* are required to be applied. The treatment as per AS 22 may be applied where such treatment is consistent with the principles of Ind AS 12. Paragraphs 26-29 of Ind AS 12 can be referred for the recognition of deferred tax as they provide sufficient guidance in this regard. Ind AS 12 provides that a deferred tax asset can result from unused tax losses and tax credits as well as from temporary differences. Deferred tax assets can only be recognised if it is probable that there will be taxable profit available against which the deductible temporary differences can be utilised/future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised. Further, paragraph 47 of Ind AS 12 states that *deferred tax assets and liabilities shall be measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.*

Accordingly, the deferred tax in respect of temporary differences which reverse during the tax holiday period is not recognised to the extent the entity's gross total income is subject to the deduction during the tax holiday

period as per the requirements of section 80-IA/80-IB of the Income Tax Act, 1961.

(ITFG Clarification Bulletin 11, Issue 2)

(Date of finalisation: July 31, 2017)

Recognition of deferred tax asset on the tax deductible goodwill in the consolidated financial statements

Issue 80: A Ltd. has two subsidiaries B Ltd. and C Ltd. and is required to comply with Ind AS from 1st April, 2017. In August 2015, B Ltd. and C Ltd. got amalgamated and as a result of the amalgamation, goodwill has been created in the separate financial statements of the amalgamated entity. The entity has decided to not restate its past business combinations in accordance with the exemption available under Ind AS 101, *First-time Adoption of Indian Accounting Standards*. This goodwill is allowed as deduction under Income tax laws in the books of the amalgamated entity. In the consolidated financial statements of A Ltd., such accounting goodwill gets eliminated as a result of consolidation adjustment. However, there is an increase in the tax base of assets in the consolidated financial statements of A Ltd. resulting from such tax deductible goodwill.

Whether deferred tax asset on the tax deductible goodwill should be recognised in the consolidated financial statements of A Ltd. prepared as per Ind AS when there is no corresponding accounting goodwill in the consolidated financial statements of A Ltd.?

Response: Paragraph 5 of Ind AS 12, *Income Taxes*, states that, *the tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes.*

Further, paragraph 7 of Ind AS 12 states that, *“The tax base of an asset is the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to an entity when it recovers the carrying amount of the asset. If those economic benefits will not be taxable, the tax base of the asset is equal to its carrying amount.”*

Further, paragraph 11 of Ind AS 12, *inter alia*, states that, the tax base is determined by reference to the tax returns of each entity in the group.

Accordingly, in the given case, the tax base of the goodwill will be the amount that will be allowed as deduction in future in accordance with the Income Tax Act, 1961.

Paragraph 9 of Ind AS 12, states as follows:

“Some items have a tax base but are not recognised as assets and liabilities in the balance sheet. For example, preliminary expenses are recognised as an expense in determining accounting profit in the period in which they are incurred but may not be permitted as a deduction in determining taxable profit (tax loss) until a later period(s). The difference between the tax base of the preliminary expenses, being the amount permitted as a deduction in future periods under taxation laws, and the carrying amount of nil is a deductible temporary difference that results in a deferred tax asset.”

In accordance with the above, a deferred tax asset may be created for assets or liabilities having a tax base but nil carrying amount in the financial statements.

As per paragraph 24 of Ind AS 12, “A deferred tax asset shall be recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised, unless the deferred tax asset arises from the initial recognition of an asset or liability in a transaction that:

- (a) is not a business combination; and
- (b) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).

However, for deductible temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, a deferred tax asset shall be recognised in accordance with paragraph 44.”

Accordingly, in the given case, deferred tax asset on the tax base of goodwill should be recognised in accordance with Ind AS 12 by crediting the consolidated statement of profit and loss, to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised, in the consolidated financial statements of A Ltd. Additionally, this will not qualify for the initial recognition exemption under paragraph 24 of Ind AS 12 as there is no initial recognition of an asset or liability arising from the amalgamation of subsidiaries in the consolidated financial statements of A Ltd (the impact of amalgamation of subsidiaries is eliminated in the consolidated financial statements of A Ltd).

*(ITFG Clarification Bulletin 10, Issue 3)
(Date of finalisation: July 05, 2017)*

Accounting treatment of dividend distribution tax (DDT) and deferred tax liability (DTL) on the accumulated undistributed profits of the subsidiary company

Issue 81: (i) P Ltd. holds 100% equity shares of S Ltd., i.e. S Ltd. is the wholly-owned subsidiary of P Ltd. During the year 2016, S Ltd. paid dividend of ₹ 100,000 to P Ltd. and paid Dividend Distribution Tax (DDT) of ₹ 20,000 (as per tax laws) to the taxation authorities.

- (a) What would be the accounting treatment of the DDT in the consolidated financial statement of P Ltd?
 - (b) Would the answer be different, if P Ltd. in turn pays dividend of ₹ 150,000 to its shareholders and DDT liability thereon is determined to be ₹ 30,000. As per the tax laws, DDT paid by S Ltd. of ₹ 20,000 is allowed as set off against the DDT liability of P Ltd., resulting in P Ltd. paying ₹ 10,000 (₹ 30,000 – ₹ 20,000) as DDT to tax authorities.
- (ii) Whether deferred tax liability (DTL) on the accumulated undistributed profits of the Subsidiary company which may be distributed in the foreseeable future is required to be recognised in the consolidated financial statements of the Parent company, i.e. P Ltd.

Response: It may be noted that the treatment of Dividend Distribution Tax (DDT) in the standalone financial statements of the parent entity and its subsidiary has been dealt with in the FAQ issued by the Accounting Standards Board (ASB) of ICAI on the treatment of Dividend distribution tax.

- (i)
- (a) In the consolidated financial statements of P Ltd., the dividend income earned by P Ltd. from S Ltd. and dividend recorded by S Ltd. in its equity will both get eliminated as a result of consolidation adjustments. DDT of ₹ 20,000 paid outside the consolidated Group i.e. to the tax authorities should be charged as expense in the consolidated statement of profit and loss of P Ltd.
 - (b) If DDT paid by the subsidiary S Ltd. is allowed as a set off against the DDT liability of its parent P Ltd. (as per the tax laws), then the amount of such DDT should be recognised in the consolidated statement of changes in equity of parent P Ltd. Accordingly, in the given situation, DDT of ₹ 30,000 (₹ 20,000 of DDT paid by S Ltd. and ₹ 10,000 of DDT

paid by P Ltd.) should be recognised in the consolidated statement of changes in equity of parent P Ltd. The basis for such accounting would be that due to Parent P Ltd's transaction of distributing dividend to its shareholders (a transaction recorded in Parent P Ltd's equity) and the related DDT set-off, this DDT paid by the subsidiary is effectively a tax on distribution of dividend to the shareholders of the Parent company.

(ii) Paragraphs 39 & 40 of Ind AS 12, *Income Taxes*, state as follows:

39 An entity shall recognise a deferred tax liability for all taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, except to the extent that both of the following conditions are satisfied:

- (a) the parent, investor, joint venturer or joint operator is able to control the timing of the reversal of the temporary difference; and*
- (b) it is probable that the temporary difference will not reverse in the foreseeable future.*

40 As a parent controls the dividend policy of its subsidiary, it is able to control the timing of the reversal of temporary differences associated with that investment (including the temporary differences arising not only from undistributed profits but also from any foreign exchange translation differences). Furthermore, it would often be impracticable to determine the amount of income taxes that would be payable when the temporary difference reverses. Therefore, when the parent has determined that those profits will not be distributed in the foreseeable future the parent does not recognise a deferred tax liability. The same considerations apply to investments in branches.

In accordance with the above, it may be noted that the deferred tax liability (DTL) is not recognised on the accumulated undistributed profits of the subsidiary company in the consolidated financial statements of the parent entity, if it is determined that such accumulated undistributed profits will not be distributed in the foreseeable future.

However, if based on evaluation of facts and circumstances, it is concluded that it is probable that the accumulated undistributed profits will be distributed in the foreseeable future, then DTL on accumulated undistributed profits of the subsidiary company should be recognised in the consolidated statement of profit and loss of the parent company. Where DDT paid by the subsidiary on distribution of its accumulated undistributed profits is allowed

as a set off against the parent's own DDT liability, then the amount of such DDT can be recognised in the consolidated statement of changes in equity of parent by crediting an equivalent amount to deferred tax expense in the consolidated statement of profit and loss of P Ltd in the period in which the set-off is availed.

In this regard, it may also be noted that the tax credit is not recognised until the conditions required to receive the tax credit are met. The tax credit on account of DDT paid by the subsidiary is recognised in the year in which they are claimed against parent's DDT liability. This is important because the payment of dividend by Parent P is decided by its shareholders and, therefore, not to recognise a DTL or to recognise any tax credit prior to such shareholder actions may not be appropriate. For example, shareholders of Parent P Ltd may decide not to distribute or even reduce the amount of dividends proposed by the Board of Directors of P Ltd.

(ITFG Clarification Bulletin 9, Issue 1)

(Date of finalisation: May 15, 2017)

Recognition of deferred tax asset on land sold as slump sale

Issue 82: A freehold land is held by PQR Ltd. which it expects to sell on a slump-sale basis and not individually. Whether PQR Ltd. is not required to recognise deferred tax asset on such land on the basis that the same will be sold on a slump sale basis and hence a temporary difference would not exist. PQR Ltd. has entered into similar slump sale arrangements in the past.

Response: As per paragraph 5 of Ind AS 12, "Temporary differences are differences between the carrying amount of an asset or liability in the balance sheet and its tax base. Temporary differences may be either:

- (a) *taxable temporary differences, which are temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled; or*
- (b) *deductible temporary differences, which are temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.*

The tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes.”

Further paragraphs 15 and 24 of Ind AS 12, state as follows:

15 *A deferred tax liability shall be recognised for all taxable temporary differences, except to the extent that the deferred tax liability arises from:*

- (a) the initial recognition of goodwill; or*
- (b) the initial recognition of an asset or liability in a transaction which:*
 - (i) is not a business combination; and*
 - (ii) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).*

However, for taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, a deferred tax liability shall be recognised in accordance with paragraph 39.

24 *A deferred tax asset shall be recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised, unless the deferred tax asset arises from the initial recognition of an asset or liability in a transaction that:*

- (a) is not a business combination; and*
- (b) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).*

However, for deductible temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, a deferred tax asset shall be recognised in accordance with paragraph 44.

In view of the above provisions of Ind AS 12, it may be noted that deferred tax asset/liability is to be created for all deductible/taxable temporary differences, except in specified situations e.g. if it arises from a transaction that affects neither accounting profit nor taxable profit (tax loss) at the time of the transaction (known as initial recognition exemption).

Paragraph 51 of Ind AS 12 further states that, “*The measurement of deferred tax liabilities and deferred tax assets shall reflect the tax consequences that would follow from the manner in which the entity expects, at the end of the*

reporting period, to recover or settle the carrying amount of its assets and liabilities.”

In accordance with the above, it may be noted that creation of deferred tax is dependent upon the tax consequences that will follow on the basis of the expected manner of recovery or settlement of the asset/liability by the entity. The expectation of the entity at the end of the reporting period with regard to the manner of recovery or settlement of its assets and liabilities will require exercise of judgement based on evaluation of facts and circumstances in each case. It may be relevant to consider that there is substance to management’s expectation of the entity being able to recover the asset through slump sale or otherwise.

However, it is also important to note the following principle of Ind AS 12:

Paragraph 51B of Ind AS 12 states that, *“If a deferred tax liability or deferred tax asset arises from a non-depreciable asset measured using the revaluation model in Ind AS 16, the measurement of the deferred tax liability or deferred tax asset shall reflect the tax consequences of recovering the carrying amount of the non-depreciable asset through sale, regardless of the basis of measuring the carrying amount of that asset. Accordingly, if the tax law specifies a tax rate applicable to the taxable amount derived from the sale of an asset that differs from the tax rate applicable to the taxable amount derived from using an asset, the former rate is applied in measuring the deferred tax liability or asset related to a non-depreciable asset.”*

In accordance with the above, it may be noted that if a non-depreciable asset is measured using the revaluation model, then an entity is required to measure the DTA/DTL considering the tax consequences of recovering the carrying amount through sale.

In the given case, PQR Ltd. will be required to evaluate facts and circumstances to assess whether the freehold land will be sold through slump sale. If it is concluded based on evaluation of facts that the land will be sold through slump sale, then the tax base of the land will be the same as the carrying amount of the land, as indexation benefit is not available in case of slump sale (as per Income Tax Act, 1961) and hence, there will not be any temporary difference.

*(ITFG Clarification Bulletin 7, Issue 7)
(Date of finalisation: March 30, 2017)*

Recognition of the deferred tax on the differences that are arising from adjustment of exchange difference to the cost of the asset

Issue 83: MNC Ltd. is a first-time adopter of Ind AS. It had taken a foreign currency loan for USD 100 million on March 31, 2013 for construction of its property, plant and equipment (PPE). The company had availed the option given under paragraph 46/46A of AS 11, *The Effects of Changes in Foreign Exchange Rates* notified under the Companies (Accounting Standards) Rules, 2006 and accordingly, exchange gain/loss on such foreign currency loan had been added to or deducted from the cost of PPE. On the date of transition to Ind AS, the Company has opted for the exemption given under paragraph D13AA of Ind AS 101, *First-time Adoption of Indian Accounting Standards*.

As per section 43A of Income Tax Act, 1961 such exchange differences capitalised are not allowed deduction under the Income Tax.

Whether deferred tax is to be recognised on such differences that are arising from adjustment of exchange difference to the cost of the asset or can it be said that these meet the initial recognition exemption under paragraph 15(b) of Ind AS 12, *Income Taxes*, and hence no deferred tax is required to be created on the same?

Response: Paragraph D13AA of Ind AS 101 states as follows:

“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.”

Further, paragraph 7AA of Ind AS 21 states as follows:

“7AA This Standard does not also apply to long-term foreign currency monetary items for which an entity has opted for the exemption given in paragraph D13AA of Appendix D to Ind AS 101. Such an entity may continue to apply the accounting policy so opted for such long-term foreign currency monetary items.”

As stated above, it may be noted that the exemption under paragraph D13AA of Ind AS 101 is available only for the exchange differences arising from translation of long-term foreign currency monetary items recognised in the financial statements immediately before the beginning of the first Ind AS financial reporting period.

As per paragraph 5 of Ind AS 12, *“Temporary differences are differences between the carrying amount of an asset or liability in the balance sheet and its tax base. Temporary differences may be either:*

- (a) taxable temporary differences, which are temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled; or*
- (b) deductible temporary differences, which are temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.*

The tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes.”

It may result in deferred tax depending on treatment of such differences under Income Tax Act, 1961 including Income Computation and Disclosure Standards (ICDS). Paragraph 15 of Ind AS 12, states as follows:

- 15 *A deferred tax liability shall be recognised for all taxable temporary differences, except to the extent that the deferred tax liability arises from:*
- (a) the initial recognition of goodwill; or*
 - (b) the initial recognition of an asset or liability in a transaction which:*
 - (i) is not a business combination; and*
 - (ii) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).*

However, for taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, a deferred tax liability shall be recognised in accordance with paragraph 39.

Similarly, paragraph 24 of Ind AS 12 states as follows:

A deferred tax asset shall be recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised, unless the deferred tax asset arises from the initial recognition of an asset or liability in a transaction that:

- (a) is not a business combination; and*

- (b) *at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).*

However, for deductible temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, a deferred tax asset shall be recognised in accordance with paragraph 44.

In accordance with the above, it may be noted that deferred taxes is required to be recognised for all taxable and deductible temporary differences except in specified situations, e.g. if it arises from initial recognition of an asset or a liability. However, adjustment to the cost of the asset due to exchange difference is a subsequent transaction and does not arise on 'the initial recognition of an asset or liability'. In other words, capitalisation of the exchange differences (including the exchange differences prior to the date of transition) represents subsequent measurement of the liability which has been adjusted to the cost of the asset. Accordingly, in the given case, initial recognition exemption will not be available and deferred tax is required to be recognised on temporary difference arising from capitalised exchange differences.

(ITFG Clarification Bulletin 8, Issue 8)

(Date of finalisation: May 05, 2017)

Accounting treatment of the interest and penalties related to income taxes

Issue 84: *How should an entity account for the interest and penalties related to income taxes, in accordance with the principles of Ind AS? Is there any conflict between the treatment as per Ind AS vis-a-vis IFRS?*

Response: Paragraph 9.7.1 of 'Guidance Note on Division II- Ind AS Schedule III to the Companies Act, 2013' issued by the ICAI states as follows:

'Any interest on shortfall in payment of advance income-tax is in the nature of finance cost and hence should not be clubbed with the Current tax. The same should be classified as Interest expense under finance costs. However, such amount should be separately disclosed.'

Any penalties levied under Income tax laws should not be classified as Current tax. Penalties which are compensatory in nature should be treated as interest and disclosed in the manner explained above. Other tax penalties should be classified under 'Other Expenses'.'

The above recommendations of the Guidance Note are based on the difference between the nature of current tax on the one hand and that of interest or penalties levied on an entity under the income-tax law on the other. As per Ind AS 12, “*current tax is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period.*” Thus, an entity’s obligation for current tax arises because it earns taxable profit during a period. An entity’s obligation for interest or penalties, on the other hand, arises because of its failure to comply with one or more of the requirements of income-tax law (e.g. failure to deposit income-tax). Thus, obligations for current tax and those for interest or penalties arise due to reasons that are fundamentally different in nature. Paragraph 29 of Ind AS 1, *Presentation of Financial Statements*, requires, *inter alia*, that “an entity shall present separately items of a dissimilar nature or function unless they are immaterial except when required by law.” It is with a view to properly reflect the difference in the nature of current tax and interest/penalties imposed under income-tax law that the Guidance Note requires interest or penalties to be not clubbed with current tax and to treat penalties that are compensatory in nature and interest as part of finance cost and to treat other penalties as part of other expenses.

It may also be mentioned where an entity is in compliance of all of the applicable requirements of income-tax law, it incurs no obligation to pay any interest or penalties, regardless of the amount of its taxable profit for the period. The amount of the entity’s taxable profit for a period, on the other hand, generally has a direct correlation with the amount of its current tax obligation for the period. However, even if the amount of interest or penalties for non-compliance with requirements of applicable income-tax law in a particular jurisdiction were linked directly to the amount of taxable profit, the differences in nature of current tax and interest/penalties would still warrant that current tax and interest/penalties not be clubbed together. In other words, similarity in a particular jurisdiction in the bases of computation of amount of current tax and interest/penalties for non-compliance is not a sufficient ground for clubbing these items, which are different in terms of their nature.

It is also pertinent to mention that as per a recent IFRIC⁵ agenda decision (in

⁵The IFRS Interpretations Committee (Interpretations Committee) is the interpretative body of the International Accounting Standards Board (Board). The Interpretations Committee works with the Board in supporting the application of IFRS Standards.

the meeting held on 12 September 2017)⁶; entities do not have an accounting policy choice between applying IAS 12 and applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* to interest and penalties. Instead, if an entity considers a particular amount payable or receivable for interest and penalties to be an income tax, then the entity applies IAS 12 to that amount. If an entity does not apply IAS 12 to a particular amount payable or receivable for interest and penalties, it applies IAS 37 to that amount. An entity discloses its judgement in this respect applying paragraph 122 of IAS 1 *Presentation of Financial Statements*, if it is part of the entity's judgements that had the most significant effect on the amounts recognised in the financial statements.

It is noted that as per the IFRIC agenda decision, there *might* be situations where an amount payable (or receivable) for interest or penalties may be in the nature of income-taxes and thus will be within the scope of IAS 12. In considering whether an amount of interest or a penalty is in the scope of IAS 12, an entity considers whether the interest or penalty is a tax and whether that tax is based on taxable profits.

In some situations it might be difficult to identify whether an amount payable to (or receivable from) a tax authority includes interest or penalties. For example, this might be the case when the total amount payable to a tax authority is negotiated as a single amount and the tax authority often issues a single demand for unpaid taxes, which might also include interest and penalties. In such situations, since it may not be possible to segregate interest and penalty component, entire amount would qualify within meaning of IAS 12.

It is noted that the applicability of IFRSs is across a large number of jurisdictions, each with its own income-tax law, therefore, an entity should determine whether a particular amount payable or receivable for interest and penalties is in the scope of IAS 12 (or Ind AS 12) considering the tax laws applicable in its individual jurisdiction. For this purpose, an entity should consider whether tax laws in the jurisdiction and other facts and circumstances indicate that this amount is based on a taxable profit – i.e. a 'net' amount. For example, in India, interest and penalty payable under section 234A/B/C will not qualify as income-taxes within the meaning of IAS

⁶Source: <https://www.ifrs.org/news-and-events/updates/ifric-updates/september-2017/#8>

12 (or Ind AS 12). Thus, the related amount will be recognised as interest (similar to the approach under the guidance note). Other interest and penalties under the Indian income tax act are also generally not expected to qualify as income-taxes.

(ITFG Clarification Bulletin 16, Issue 2)

(Date of finalisation: September 04, 2018)

Recognition of deferred tax on conversion of capital asset into stock-in-trade

Issue 85: Z Ltd. had purchased land as capital asset as on 1.1.2007. On 1.1.2016, Z Ltd. converted the land into stock-in-trade. It is required to adopt Ind AS from 1.4.2018 being the transition date on 01.04.2017. On the date of transition, Z Limited continues to recognise land at historical cost, i.e., there is no change in its carrying amount. Whether, on the date of transition, the company is required to create deferred tax on the differential land value on 01.01.2016, the date on which capital asset (Land) was converted into stock in trade. Further, in case, the company needs to create deferred tax based on the fair value as on 01.1.2016 then again there will be difference in book base and tax base of inventory (Land) on the date of transition. Whether Z Ltd is also required to create deferred tax on the Stock-in-trade?

Response: As per paragraph 5 of Ind AS 12, *Income Taxes*, “Temporary differences are differences between the carrying amount of an asset or liability in the balance sheet and its tax base. Temporary differences may be either:

- (a) *taxable temporary differences, which are temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled; or*
- (b) *deductible temporary differences, which are temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.*

The tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes.”

Further paragraphs 15 and 24 of Ind AS 12, state as follows:

- 15 *A deferred tax liability shall be recognised for all taxable temporary differences, except to the extent that the deferred tax liability arises*

from:

- (a) the initial recognition of goodwill; or
- (b) the initial recognition of an asset or liability in a transaction which:
 - (i) is not a business combination; and
 - (ii) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).

However, for taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, a deferred tax liability shall be recognised in accordance with paragraph 39.

- 24 A deferred tax asset shall be recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised, unless the deferred tax asset arises from the initial recognition of an asset or liability in a transaction that:

- (a) is not a business combination; and
- (b) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).

However, for deductible temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, a deferred tax asset shall be recognised in accordance with paragraph 44.

In view of the above provisions of Ind AS 12, it may be noted that deferred tax asset/liability is to be created for all deductible/taxable temporary differences between the carrying amount of an asset or liability in the balance sheet and its tax base, except in specified situations e.g. if it arises from a transaction that affects neither accounting profit nor taxable profit (tax loss) at the time of the transaction (known as initial recognition exemption). In addition, recognition of deferred tax asset will be subject to consideration of prudence.

Paragraph 51 of Ind AS 12 further states that, “The measurement of deferred tax liabilities and deferred tax assets shall reflect the tax consequences that would follow from the manner in which the entity expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.”

In accordance with the above, it may be noted that deferred tax arises may arise only if a difference exists between the carrying amount of an asset or liability in the balance sheet and its tax base. Also, the creation of deferred tax is dependent upon the tax consequences that will follow from the expected manner of recovery or settlement of the asset/liability by the entity. The expectation of the entity at the end of the reporting period with regard to the manner of recovery or settlement of its assets and liabilities will require exercise of judgement based on evaluation of facts and circumstances in each case.

In the given case, based on the facts provided, Z Ltd. had converted its capital asset into stock-in-trade which will then be sold as inventory.

It is pertinent to note that as per Income tax laws on conversion of a capital asset into stock-in-trade, and thereafter, sale of the stock-in-trade, the tax treatment will be as follows:

- (i) There will be capital gains liability in respect of the conversion of capital asset into stock-in-trade, at market value thereof on the date of conversion. Thus, the capital gains will be computed as the difference between the indexed cost of capital asset to the assessee and the fair market value of such capital asset on the date of its conversion into stock-in-trade.

However, the tax will be computed using the capital gains tax rate applicable in the year of actual sale and not in the year of conversion. Also, the capital gains tax will be required to be paid only at the time of sale of the stock-in-trade.

- (ii) As regard the sale of the stock-in-trade, any profit realised or loss incurred (i.e., difference between the sale proceeds and fair value on the date of conversion) will be liable to tax as business income. Such profit/loss would accrue and be liable to tax at the time of sale of the stock-in-trade.
- (iii) If there is a business loss in the year of sale of stock-in-trade, the Income-tax Act allows the loss to be offset against capital gains arising on conversion. Thus, the liability for capital gain tax on conversion is not sacrosanct and can vary depending on outcome from sale of stock-in-trade.

Considering the above, conversion of capital asset into stock-in-trade does not require the company to recognise any current tax liability. Under the Income-tax Act, the current tax liability will arise only on the sale of stock-in-trade. However, the company needs to consider deferred tax implications

under Ind AS 12. The deferred tax implications arise from the fact that while computing long-term capital gains, assessee will be entitled to avail capital indexation benefits provided under the Income Tax Act, 1961. Therefore, on the date of transition to Ind AS (i.e. on 1.4.2017), a deductible temporary difference exists for Z Ltd. arising out of the carrying amount of asset (as on 1.1.2016) and its tax base (calculated as on 1.1.2016, considering indexation benefit). Z Limited should recognise a deferred tax asset for the same if it satisfies deferred tax asset recognition criteria under Ind AS 12. The difference between the indexed cost of land on the date of conversion and its fair value does not meet definition of temporary difference under Ind AS 12. Also, the business income will be computed as a difference between the sale price of the stock-in-trade and market value of the capital asset on the date of its conversion into stock-in-trade. Therefore, no deferred tax at this stage arises for these two aspects of the transaction. This is explained by way of an example as follows:

Cost of land as on 1.1.2007 was ₹ 100. The land will continue to be recognised at the same amount post the date of transition to Ind AS also.

As on 1.1.2016, the fair value of the land was ₹ 1000. Indexed cost of land as on 1.1.2016 was ₹ 150.

Land is sold in the year 2020 for ₹ 1200.

Now, as per tax laws there will be gain of ₹ 1050 (₹ 1200-₹ 150) which will be apportioned as follows:

Tax on Gain of ₹ 850/- (₹ 1000-₹ 150) will be charged as Capital gains tax.

Tax on Gain of ₹ 200/- (₹ 1200-₹ 1000) will be charged as Profits & Gains of Business & Profession (PGBP).

There are differing tax rates for income from capital gains and income from PGBP.

Considering the above, as per Ind AS 12, deferred tax on the date of transition to Ind AS will be computed as below:

Tax base (Indexed cost of land as on 1 January 2016)	₹ 150
Carrying amount	₹ 100
Deductible temporary difference	₹ 50

Deferred tax asset (DTA) should be created for the above deductible difference of ₹ 50 assuming that Ind AS 12 criteria for deferred tax asset recognition are met. Furthermore, the tax base of the land (which has been

classified as inventory) for subsequent period would remain the same as indexed cost of the land on the date of such classification (i.e. 1.1.2016). Hence, there will be no change in deductible temporary difference till the year of sale, i.e., year 2020. In any case, Z Ltd. will continue to evaluate recognition and measurement of deferred tax asset based on Ind AS 12 principles.

In the year of sale, current tax as mentioned above will be payable and recognised as such. Also, it will result into reversal/ realisation of deferred tax asset, if any, recognised for land in the earlier periods.

The example above is only for illustrative purposes and should not be considered as an advice for income tax purpose.

*(ITFG Clarification Bulletin 17, Issue 7)
(Date of finalisation: December 19, 2018)*

Ind AS 16, Property, Plant and Equipment

Accounting Treatment of expenditure on the construction/development of railway siding, road and bridge to facilitate the construction of a new refinery

Issue 86: ABC Ltd is setting up a new refinery outside the city limits. In order to facilitate the construction of the refinery and its operations, ABC Ltd. is required to incur expenditure on the construction/development of railway siding, road and bridge. Though ABC Ltd. incurs (or contributes to) the expenditure on the construction/development, it will not have ownership rights on these items and they are also available for use to other entities and public at large. Whether ABC Ltd. can capitalise expenditure incurred on these items as property, plant and equipment (PPE)? If yes, how should these items be depreciated and presented in the financial statements of ABC Ltd.?

Response: Paragraph 7 of Ind AS 16 states that “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.”*

Further, paragraph 9 of Ind AS 16 provides that, “This Standard does not prescribe the unit of measure for recognition, i.e., what constitutes an item of property, plant and equipment. Thus, judgement is required in applying the recognition criteria to an entity’s specific circumstances. It may be appropriate to aggregate individually insignificant items, such as moulds, tools and dies, and to apply the criteria to the aggregate value.”

Paragraph 16 of Ind AS 16, *inter alia*, states that the cost of an item of property, plant and equipment comprise any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

In the given case, railway siding, road and bridge are required to facilitate the construction of the refinery and for its operations. Expenditure on these items is required to be incurred in order to get future economic benefits from the

project as a whole which can be considered as the unit of measure for the purpose of capitalisation of the said expenditure even though the company cannot restrict the access of others for using the assets individually. It is apparent that the aforesaid expenditure is directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

In view of this, even though ABC Ltd. may not be able to recognise expenditure incurred on these assets as an individual item of property, plant and equipment in many cases (where it cannot restrict others from using the asset), expenditure incurred may be capitalised as a part of overall cost of the project. From this, it can be concluded that, in the extant case the expenditure incurred on these assets, i.e., railway siding, road and bridge, should be considered as the cost of constructing the refinery and accordingly, expenditure incurred on these items should be allocated and capitalised as part of the items of property, plant and equipment of the refinery.

Depreciation

As per paragraph 43 of Ind AS 16, each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately.

Further, paragraph 45 of Ind AS 16 provides that, a significant part of an item of property, plant and equipment may have a useful life and a depreciation method that are the same as the useful life and the depreciation method of another significant part of that same item. Such parts may be grouped in determining the depreciation charge.

In view of the above, if these assets have a useful life which is different from the useful life of the item of property, plant and equipment to which they relate, it should be depreciated separately. However, if these assets have a useful life and the depreciation method that are the same as the useful life and the depreciation method of the item of property, plant and equipment to which they relate, these assets may be grouped in determining the depreciation charge. Nevertheless, if it has been included in the cost of property, plant and equipment as a directly attributable cost, it will be depreciated over the useful lives of the said property, plant and equipment. The useful lives of these assets should not exceed that of the asset to which it relates.

Presentation

These assets should be presented within the class of asset to which they relate.

(ITFG Clarification Bulletin 11, Issue 8)
(Date of finalisation: July 31, 2017)

Selection of valuation model of immovable properties

Issue 87: (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:

“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.

(ITFG Clarification Bulletin 12, Issue 1)

(Date of finalisation: October 23, 2017)

Accounting treatment of the wrongly capitalised asset which does not meet the definition of tangible asset

Issue 88: ABC Ltd. is a first-time adopter of Ind AS and has opted for deemed cost exemption as per paragraph D7AA of Ind AS 101, *First-time Adoption of Indian Accounting Standards*. It had capitalised an item of property, plant and equipment under previous GAAP even though it did not meet the definition of an asset. Whether this asset cost can also be continued to be capitalised under deemed cost exemption/

Response: Paragraph D7AA of Ind AS 101, provides 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 Ind AS 101.”

In accordance with the above, the option of deemed cost exemption can be availed for property, plant and equipment measured as per previous GAAP. The incorrect capitalisation of the item of property, plant and equipment did not meet the definition of asset as per previous GAAP and the definition of ‘Property, plant and equipment’ as per Ind AS 16, accordingly the deemed cost exemption under paragraph D7AA of Ind AS 101 cannot be availed for those assets.

Further, it is important to note the provisions of paragraph 10 of Ind AS 101, which states that, “Except as described in paragraphs 13–19 and Appendices B–D, an entity shall, in its opening Ind AS Balance Sheet:

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- (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.”*

Paragraph 26 of Ind AS 101 provides that, *‘If an entity becomes aware of errors made under previous GAAP, the reconciliations required by paragraph 24(a) and (b) shall distinguish the correction of those errors from changes in accounting policies.’*

Further, paragraph 24 of Ind AS 101 provides that, *“To comply with paragraph 23, an entity’s first Ind AS financial statements shall include:*

- (a) *reconciliations of its equity reported in accordance with previous GAAP to its equity in accordance with Ind ASs for both of the following dates:*
 - (i) *the date of transition to Ind ASs; and*
 - (ii) *the end of the latest period presented in the entity’s most recent annual financial statements in accordance with previous GAAP.*
- (b) *a reconciliation to its total comprehensive income in accordance with Ind ASs for the latest period in the entity’s most recent annual financial statements. The starting point for that reconciliation shall be total comprehensive income in accordance with previous GAAP for the same period or, if an entity did not report such a total, profit or loss under previous GAAP.”*

In view of the above, the incorrect capitalisation of asset which does not meet the definition of tangible asset will be covered under paragraph 26 of Ind AS 101 being an error, and the disclosure of the same should be done as per paragraph 24 of Ind AS 101 as mentioned above.

(ITFG Clarification Bulletin 8, Issue 4)

(Date of finalisation: May 05, 2017)

Re-computation of Depreciation based on useful life when Ind AS 16 applied retrospectively

Issue 89: 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, paragraphs 13 & 14 of Ind AS 101, *First-time Adoption of Indian Accounting Standards* state 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.

(ITFG Clarification Bulletin 3, Issue 14)

(Date of finalisation: June 22, 2016)

Property, plant and equipment - capitalisation of capital spares when deemed cost exemption availed for property, plant and equipment on transition to Ind AS.

Issue 90: 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.

(ITFG Clarification Bulletin 3, Issue 9)

(Date of finalisation: June 22, 2016)

Property, Plant and Equipment - Capitalisation of expenditure on assets not owned by the company

Issue 91: Company X has incurred expenditure on construction of a road on the land which is not owned by the Company. Whether the expenditure incurred on construction of such a road by the Company has to be capitalised or expensed out under Ind AS?

Response: The capitalisation of expenditure incurred on construction of assets on land not owned by a company would depend on facts and circumstances of each case, particularly, considering paragraph 16(b) of Ind AS 16, *Property, Plant and Equipment (PPE)*, which states that such an expenditure should be necessary for making the item of PPE capable of operating in the manner intended by the management.

(ITFG Clarification Bulletin 2, Issue 5)

(Date of finalisation: April 12, 2016)

Property Plant and Equipment- Recognition Criteria of spare part as an item of property, plant and equipment and depreciation thereon

Issue 92: A Company has a spare part, which it terms as 'insurance spare', is required to be used along with equipment. Whether the spare part is required to be recognised as part of that equipment? Whether depreciation is required to be calculated separately for that spare part or along with the equipment for which it has been used?

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 part has to be recognised as property, plant and equipment separately from the equipment. If that spare part does not meet the definition and recognition criteria as cited above that spare part is to be recognised as inventory.

The depreciation on such an item of spare part will begin when the asset is available for use i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. In case of a spare part, as it may be readily available for use, it may be depreciated from the date of purchase of the spare part. In determination of the useful life of the spare part, the life of the machine in respect of which it can be used can be one of the determining factors.

*(ITFG Clarification Bulletin 2, Issue 4)
(Date of finalisation: April 12, 2016)*

Accounting of spare parts which meet the definition of property, plant and equipment on the date of transition

Issue 93: XYZ Ltd. is covered under Ind AS roadmap and needs to comply Ind AS from financial year 2016-17. It has recorded certain spare parts in its previous GAAP financial statements as a part of inventory. As per paragraph 8 of Ind AS 16, these items meet the definition of 'property, plant and equipment' and required to be capitalised as PPE on the date of transition to Ind AS. In this regard, clarify the issues given below:

- (i) **At what amount such spare parts should be recognised in the first Ind AS financial statements? Whether depreciation should be charged from the date when the same became available for use or date of actual use?**
- (ii) **Explain the words 'more than one period' used in definition of property, plant and equipment.**

Response: (i) As per Ind AS 16, *Property, Plant and Equipment*, '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.

Further paragraph 7 of Ind AS 16, 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."

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

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 [Refer - Issue 9 of ITFG Clarification Bulletin 3].

As per paragraph 10 of Ind AS 101, except for the mandatory exceptions and voluntary exemptions provided in Ind AS 101, an entity shall, in its opening Ind AS Balance Sheet:

- (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.

Paragraphs D5 to D8B provide various deemed cost exemptions that an entity may elect to use on the date of transition. In this regard, it is pertinent to note that paragraph D7AA of Ind AS 101 provides an option to continue the carrying values 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 if there is no change in its functional currency. However, the above exemption cannot be used for such spare parts in the given case since the same were not recognised as fixed assets, i.e., PPE, in the previous GAAP.

Moreover, paragraph D7AA does not prevent a company to recognise an asset as PPE whose recognition is required by Ind AS on the date of transition [Refer Issue 9 of ITFG Clarification Bulletin 3].

In view of the above, the entity should apply applicable Ind AS i.e. Ind AS 16 retrospectively to measure the amount that will be recognised for such spare parts on the date of transition to Ind AS.

With regard to depreciation, paragraph 50 of Ind AS 16 provides that the depreciable amount of an asset shall be allocated on a systematic basis over its useful life.

As per paragraph 6 of Ind AS 16, **Useful life** is:

- (a) the period over which an asset is expected to be available for use by an entity; or
- (b) the number of production or similar units expected to be obtained from the asset by an entity.

Paragraph 55 of Ind AS 16, *inter alia*, provides that depreciation of an asset begins when it is available for use, i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by management.

Spare parts are generally available for use from the date of its purchase. Accordingly, spare parts recognised as property, plant and equipment shall be depreciated when the same are available for use.

- (ii) 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.

Accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.

The term 'more than one period' is not defined in Ind AS. Ordinarily, the accounting policies are determined for preparing and presenting financial statements on annual basis.

Accordingly, the term 'period', should ordinarily be construed to be the annual period.

(ITFG Clarification Bulletin 5, Issue 6)

(Date of finalisation: September 19, 2016)

Accounting treatment of the Revaluation surplus as per previous GAAP on transition date and Revaluation gain arising after transition date when Ind AS 16 applied retrospectively

Issue 94: PQR Ltd. is under Phase II of Ind AS roadmap. On the date of transition i.e. 1.4.2016, it has elected not to use deemed cost exemption given under Ind AS 101, *First-time Adoption of Indian Accounting Standards* for measuring its property, plant and equipment. It has opted to retrospectively apply the requirements of Ind AS 16, *Property, Plant and Equipment* to all items of property, plant and equipment and has opted for revaluation model of Ind AS 16 for subsequent measurement. PQR Ltd. has been applying revaluation model under previous Indian GAAP.

What will be the accounting treatment of the following revaluation surplus in the Ind AS financial statements of PQR Ltd:

- a) Revaluation surplus as per previous GAAP on transition date;
- b) Revaluation gain arising after transition date.

Would the answer be different if the company would have opted for deemed cost exemption under paragraph D5 of Ind AS 101.

Response: Paragraph 39 of Ind AS 16, *Property, Plant and Equipment* states as follows:

*39 If an asset's carrying amount is **increased as a result of a revaluation**, the increase shall be **recognised in other comprehensive income** and accumulated in equity under the heading of revaluation surplus. However, the increase shall be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss.*

Further, as per Ind AS 1, *Presentation of Financial Statements*, other comprehensive income comprises items of income and expense (including reclassification adjustments) that are not recognised in profit or loss as required or permitted by other Ind ASs. The components of other comprehensive income includes changes in revaluation surplus (see Ind AS 16, *Property, Plant and Equipment* and Ind AS 38, *Intangible Assets*);

In accordance with the above, as per Ind AS 16, revaluation increase should be recognised in other comprehensive income.

- (a) In the given case, the company has not elected deemed cost exemption given under Ind AS 101 and has chosen to apply the requirements of Ind AS 16 retrospectively. Assuming the other requirements of Ind AS 16 are met, the company would apply revaluation model of Ind AS 16 to its PPE and the revaluation reserve on transition date determined in accordance with the requirements of Ind AS 16 (carried from previous GAAP) will be recognised as revaluation surplus in equity. The opening balance of revaluation surplus as per previous GAAP should be transferred to retained earnings or if appropriate, another category of equity.
- (b) Any revaluation gains arising on subsequent recognition, i.e. after the date of transition, will be recognised in the Other Comprehensive Income.

If the company would have opted exemption under paragraph D5 of Ind AS 101 at the date of transition then the opening balance of revaluation surplus as per previous GAAP should be transferred to retained earnings or if appropriate, another category of equity disclosing the description of the nature and purpose of such amount in accordance with the requirements of paragraph 79(b) of Ind AS 1, *Presentation of Financial Statements*.

This aspect has also been clarified in ITFG Clarification Bulletin 8 (Issue 7).

Accordingly, at the date of transition if a company opts for deemed costs under Ind AS 101, then all revaluations under the previous GAAP up to the date of transition, i.e. opening balance of revaluation reserve will be transferred to retained earnings (or, if appropriate another category of equity) and changes in revaluations after the date of transition (i.e. subsequent recognition) will be recognised through OCI. *It may be noted that if the company has chosen to use revaluation model for subsequent measurement then it has to apply the same policy for all the periods (including transition date) presented in the first Ind AS financial statements.*

*(ITFG Clarification Bulletin 14, Issue 6)
(Date of finalisation: February 01, 2018)*

Ind AS 17, Leases

Classification of land lease under Ind AS

Issue 95: XYZ Ltd. has obtained a land from the government on a long-term lease basis which spans 99 years and above. At the end of the lease term, the lease could be extended for another term or the land could be returned to the government authority. Whether such land leases should be classified as finance lease or operating lease in the financial statements of XYZ Ltd. prepared in accordance with Ind AS?

Response: Paragraph 4 of Ind AS 17, *Leases*, *inter alia*, provides as follows:

“A finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not be eventually be transferred.

An operating lease is a lease other than a finance lease.”

Further, paragraph 15A of Ind AS 17, states as follows:

“15A When a lease includes both land and buildings elements, an entity assesses the classification of each element as a finance or an operating lease separately in accordance with paragraphs 7–13. In determining whether the land element is an operating or a finance lease, an important consideration is that land normally has an indefinite economic life.”

Therefore, one important consideration for evaluating lease of land is that land has an indefinite economic life and it is expected that the value of land generally appreciates.

Paragraphs 10 & 11 of Ind AS 17, *Leases* state as follows:

“10 Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are:

- (a) the lease transfers ownership of the asset to the lessee by the end of the lease term;*
- (b) the lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised;*

- (c) *the lease term is for the major part of the economic life of the asset even if title is not transferred;*
- (d) *at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and*
- (e) *the leased assets are of such a specialised nature that only the lessee can use them without major modifications.*

11 Indicators of situations that individually or in combination could also lead to a lease being classified as a finance lease are:

- (a) *if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;*
- (b) *gains or losses from the fluctuation in the fair value of the residual accrue to the lessee (for example, in the form of a rent rebate equalling most of the sales proceeds at the end of the lease); and*
- (c) *the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent."*

In case of lease of land for 99 years and above, if it is likely that such leases meet the criteria that at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset then in this case, such lease will be classified as 'finance lease'.

However, it may also be noted that land normally has an indefinite economic life. Where in substance there is no transfer of risks and rewards, it should be considered as an operating lease. Some of the indicators to consider in the overall context of whether there is transfer of risks and rewards incidental to ownership include the lessee's ability to renew lease for another term at substantially below market rent, lessee's option to purchase at price significantly below fair value etc.

Accordingly, classification as operating or finance lease requires exercise of judgement based on evaluation of facts and circumstances in each case, while considering the indicators envisaged as above.

*(ITFG Clarification Bulletin 7, Issue 5)
(Date of finalisation: March 30, 2017)*

Straight-lining of lease payments if escalation of lease payments is different from general inflation.

Issue 96: ABC Ltd. has entered into an operating lease agreement for taking a building on lease. The rent agreement is for 5 years with escalation of lease rent at the rate of 15% p.a. The general inflation in the country expected for the aforesaid period is around 6%.

Shall the lease payments be straight-lined or not as per Ind AS 17? If yes, should the entire 15% p.a. escalation in lease rent be straight-lined over a period of 5 years or only the difference which exceeds the expected inflation rate will be straight-lined?

Response: Paragraph 33 of Ind AS 17, *Leases*, states as follows:

“Lease payments under an operating lease shall be recognised as an expense on a straight-line basis over the lease term unless either:

- (a) another systematic benefit is more representative of the time pattern of the user’s benefit even if the payments to the lessors are not on that basis; or*
- (b) 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 condition is not met.”*

As per paragraph 33 of Ind AS 17, lease payments shall be straight-lined over the period of lease unless, *inter alia*, 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 lease payments shall be straight-lined.

Judgement would be required to be made as per the facts and circumstances of each case to determine whether the payments to the lessor are structured to increase in line with expected general inflation. Therefore, it is required to evaluate the lease agreement to ascertain the real intention and attributes of escalation in lease payments, i.e., whether the intention of such escalation is to compensate for expected general inflation or any other factors.

It is not necessary that the rate of the escalation of lease payments should exactly be equal to the expected general inflation. If the actual increase or decrease in the rate of inflation is not materially different as compared to the expected rate of inflation under the lease agreement, it is not required to straight-line the lease payments. However, the purpose of such escalation should only be to compensate the expected general inflation rate.

In the given case, the increase of 15% p.a. in lease rentals does not appear to have any link with general inflation which is expected to be 6%. Accordingly, the entire lease payments should be straight-lined since the increase is not a compensation for inflation.

(ITFG Clarification Bulletin 5, Issue 7)

(Date of finalisation: September 19, 2016)

Accounting treatment of restoration costs in case of a leasehold land

Issue 97: A company is using a leasehold land for its business purposes. As per the lease terms, the company is under an obligation to restore the land to its original condition at the end of the lease tenure. What should be the accounting treatment of restoration costs in case of a leasehold land?

Response: The Company will be required to first evaluate whether the lease is a finance lease or an operating lease, in accordance with the principles of Ind AS 17, *Leases*.

If it is determined that the lease is a finance lease, then as per paragraph 16(c) of Ind AS 16, *Property, Plant and Equipment*, the cost of an item of property, plant and equipment comprises the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets* contains requirements on how to measure decommissioning, restoration and similar liabilities. Further, Appendix A to Ind AS 16 also provides guidance on how to account for the effect of changes in the measurement of existing decommissioning, restoration and similar liabilities.

Paragraph 8 of Appendix A of Ind AS 16 states that the periodic unwinding of the discount shall be recognised in profit or loss as a finance cost as it occurs. Capitalisation under Ind AS 23 is not permitted.

In accordance with the above, all site restoration costs need to be estimated and capitalised at initial recognition, in order that such costs can be recovered over the life of the item of property, plant and equipment, even if the expenditure will only be incurred at the end of the item's life. Where an obligation exists to restore a site to its former condition at the end of its useful life, the present value of the related future payments is capitalised

along with the cost of acquisition or construction upon completion and a corresponding liability is recognised.

Thereafter, the asset comprising the decommissioning cost is depreciated over its useful life, while the discounted provision is progressively unwound, with the unwinding charge shown as finance cost in accordance with paragraph 8 of Appendix A of Ind AS 16 as stated above.

Alternatively, if it is determined that the lease is an operating lease and the entity incurs amount to construct the asset/ structure on land which it is required to remove those on expiration of the lease, it should account for the removal obligation as it has a present obligation under the lease to remove the improvements at the end of the lease term. In such situations, the entity will capitalise leasehold building/improvements and amortise them over the term of the lease. The removal obligation arises when the entity completes the construction, which is the past event. The present value of expected outflow should be recognised as a liability when the construction is completed. An asset of the same amount should be recognised and amortised over the remaining lease term.

(ITFG Clarification Bulletin 14, Issue 2)

(Date of finalisation: February 01, 2018)

Recognition of income in respect of lease in case of nominal lease rent payment

Issue 98: XYZ Limited is a government company and is required to comply with Ind AS. It is in the business of development of smart city. For development of smart city, XYZ Ltd. allots its land to customer on 99 years of lease. The customer is required to pay lease premium at the time of execution of lease deed and lease rent on annual basis over a period of 99 years. The lease premium amount is the market value of land and lease rent is nominal amount say Re. 1 per square meter per year. The lease premium is non-refundable.

As per the lease terms, on completion of 99 years, the lease is renewable at mutual consent of lessor and lessee.

How would income in respect of lease premium collected by the XYZ Limited (which is the market value of land and is not refundable) at the time of execution of lease deed be recognised as per Ind AS. For subsequent years, only nominal lease rent is collected.

Response: Paragraph 6 of Ind AS 18, *Revenue* scopes out revenue arising from lease agreements. Principles enunciated under Ind AS 17, *Leases* would be applicable for revenue arising from leasing agreements.

Recognition of income in respect of lease would depend on its classification as per Ind AS 17, *Leases*.

It may be noted that ITFG Clarification Bulletin 7 (Issue 5) deals with the broad principles to be kept in mind while classifying lease as operating or finance lease. It also states that it requires exercise of judgement based on evaluation of facts and circumstances in each case, while considering the indicators given in Ind AS 17.

If it is concluded that lease is an operating lease, then it will be accounted for in accordance with paragraphs 49 and 50 of Ind AS 17, *Leases*, as given below:

49 Lessors shall present assets subject to operating leases in their balance sheet according to the nature of the asset.

50 Lease income from operating leases (excluding amounts for services such as insurance and maintenance) shall be recognised in income on a straight-line basis over the lease term, unless either:

- (a) another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished, even if the payments to the lessors are not on that basis; or*
- (b) 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 factors other than inflation, then this condition is not met.*

If it is concluded that lease is a finance lease then in accordance with paragraphs 36 and 39 of Ind AS 17, lessors shall recognise assets held under a finance lease in their balance sheets and present them as a receivable at an amount equal to the net investment in the lease. 'The recognition of finance income shall be based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the finance lease.

In the given case, the long lease term may be an indication that the lease is classified as a finance lease subject to the consideration of other relevant facts and circumstances. If it is so classified, the lessor should carry out the accounting for finance lease as explained above and there will be no receivable, since the entire amount is received upfront.

(ITFG Clarification Bulletin 15, Issue 8)

(Date of finalisation: April 04, 2018)

Classification of the the infrastructure usage rights under the lease

Issue 99: A Ltd. has entered into a long term lease of 99 years for a land in a textile park. As per the lease agreement, A Ltd. is required to pay nominal annual rent at the rate of Re. 1/ sq.mtr. without any upfront payment. Further A Ltd. has made a payment of a material amount (say 150 crores) as the lumpsum payment towards using the common infrastructure facilities of the park for the period of 99 years.

Whether the above lease transaction should be classified as an operating lease or finance lease as per Ind AS, provided the following terms:

- No initial amount has been paid towards such lease.
- A Ltd. has no option to purchase the land at a price that is sufficiently lower than fair value at the date option is exercisable.
- The renewal of the lease is based on the mutual acceptance at the end of lease term.
- Lessor has not agreed to renew lease on expiry of lease term

Further, whether the infrastructure usage rights should be classified under intangible assets or should be considered as part of land lease?

Response: It is noted that as per the terms of agreement between A Ltd and the owner of the textile park, A Ltd. is required to pay annual lease rent at the rate of Re. 1/ sq.mtr. during the entire lease term of 99 years. Additionally, A Ltd. has made a large lump sum payment upfront which is stated to be towards using the common infrastructure facilities of the park for the said period of 99 years. In the given case the stated lease rental for land is no more than nominal, the lump sum amount paid upfront also includes an element towards land lease rentals, notwithstanding that the agreement states that the lump sum payment is (only) towards use of common infrastructure facilities of the park.

The entity is required to evaluate whether the lease of land is a finance lease or an operating lease based on the definitions of 'finance lease' and 'operating lease' and indicators for classification of lease given under Ind AS 17, Leases. Reference may also be made in this regard to ITFG Clarification Bulletin 7 (Issue 5) which emphasises that the classification of a lease under Ind AS 17 requires exercise of judgement in the context of facts and circumstances of each case.

The agreement provides A Ltd. the right of use of both land and common infrastructure facilities even though the right of use of land is exclusive whereas the right of use of common infrastructure facilities is non-exclusive. It may also be argued that common infrastructure facilities such as access roads are essential for A Ltd to be able to utilise its rights in relation to land. Accordingly, while applying Ind AS 17, the right of use of both land and common infrastructure facilities may be viewed as a single set of rights unless the terms of the agreement such as tenure, renewal option, etc. in respect of the two are different (which does not seem to be the case). If the two rights are accounted for as a single item, the relevant line item in the balance sheet may bring out clearly that it relates to right of use of both land and common infrastructure facilities. If on the other hand the two rights are accounted for separately (because of differences in the terms and underlying benefits relating to the two), accounting for each right should be based on the particular terms and underlying benefits associated with it.

It also needs to be assessed that whether the textile park is providing services in the form of common infrastructure facilities. As per Ind AS 17, costs for services are excluded from minimum lease rentals. Where it is concluded that textile part is providing services for tenure of the land then in such case the upfront payment has to be split between minimum lease payment towards lease of land and prepayment for future services. The amount allocated to MLPs towards lease of land has to be considered for the purpose of determining classification of lease between operating or finance lease.

(ITFG Clarification Bulletin 16, Issue 6)

(Date of finalisation: September 04, 2018)

Ind AS 18, Revenue

Classification of expense of providing free third party goods under Customer Loyalty Programmes

Issue 100: Company X participated in a customer loyalty programme operated by a third party. Under the programme, members earn points for purchases made in X's stores. The members can redeem the accumulated award points for goods supplied by the third party. X has fulfilled its obligation to programme members once the members have been granted points when making purchases in its stores. The obligation to supply the redeemed goods lies with the third party. At the end of 31 March 2017, X has granted award points with an estimated fair value of ₹ 20,000 and owes the third party ₹ 17,000.

In the above situation, what should be the classification of the expense of providing free third party goods i.e. in the above example, should ₹ 17,000 be:

- classified as changes in inventories of finished goods, stock in trade and WIP or
- classified as marketing expense or
- reduced from revenue?

Response: Paragraph 8 of Appendix B, *Customer Loyalty Programmes* of Ind AS 18, *Revenue* states as follows:

"8 If a third party supplies the awards, the entity shall assess whether it is collecting the consideration allocated to the award credits on its own account (i.e. as the principal in the transaction) or on behalf of the third party (i.e. as an agent for the third party).

- (a) *If the entity is collecting the consideration on behalf of the third party, it shall:*
 - (i) *measure its revenue as the net amount retained on its own account, i.e. the difference between the consideration allocated to the award credits and the amount payable to the third party for supplying the awards; and*
 - (ii) *recognise this net amount as revenue when the third party*

becomes obliged to supply the awards and entitled to receive consideration for doing so. These events may occur as soon as the award credits are granted. Alternatively, if the customer can choose to claim awards from either the entity or a third party, these events may occur only when the customer chooses to claim awards from the third party.

- (b) *If the entity is collecting the consideration on its own account, it shall measure its revenue as the gross consideration allocated to the award credits and recognise the revenue when it fulfills its obligations in respect of the awards.”*

In accordance with the above, if the entity is acting as a principal then it shall recognise the revenue at gross amount and the expense of providing free third party goods will be included in the cost of goods sold.

If the entity is acting as an agent, then in accordance with paragraph 8(a) (i), it shall measure its revenue at the net amount, i.e. the difference between the consideration allocated to the award credits and the amount payable to the third party.

Accordingly, in the given case the entity will assess based on facts and circumstances as to whether it is acting as an agent or principal. If it is determined that Company X is acting as an agent, then entity will recognise commission income of ` 3,000. If it is determined that Company X is acting as a principal, then company X shall recognise revenue of ` 20,000 and ` 17,000 shall be charged to the Statement of Profit & Loss as cost of goods sold

(ITFG Clarification Bulletin 10, Issue 6)

(Date of finalisation: July 5, 2017)

Revenue Recognition - Treatment of Service Tax

Issue 101: How revenue should be recognised in case Service Tax is collected from customer for rendering of services?

Response: Paragraph 8 of Ind AS 18, *inter alia*, provides that revenue includes only the gross inflows of economic benefits received and receivable by the entity on its own account. Amounts collected on behalf of third parties such as sales taxes, goods and services taxes and value added taxes are not economic benefits which flow to the entity and do not result in increases in equity. Therefore, they are excluded from revenue.

In view of the above, since service tax collected represents the amount collected on behalf of a third party, viz., the government, revenue should be net of service tax collected.

(ITFG Clarification Bulletin 4, Issue 2)

(Date of finalisation: August 19, 2016)

Revenue Recognition - presentation of Excise Duty (Gross or net of sales)

Issue 102: ABC Ltd., which is a manufacturer of TV sets, sells a TV at ` 50,000 which includes excise duty of ` 5,000. What is the amount to be recognised as revenue? How excise duty should be presented in financial statements? Is there any change in the presentation of excise duty as compared to presentation prescribed in AS 9?

Response: Paragraph 8 of Ind AS 18, *inter alia*, provides that revenue includes only the gross inflows of economic benefits received and receivable by the entity on its own account. Amounts collected on behalf of third parties such as sales taxes, goods and services taxes and value added taxes are not economic benefits which flow to the entity and do not result in increases in equity. Therefore, they are excluded from revenue.

Excise duty is a liability of the manufacturer which forms part of the cost of production, irrespective whether the goods are sold or not. Therefore, recovery of excise duty flows to the entity on its own account and the same should be included in the amount of revenue. Accordingly, in the present case, revenue should be recognised at ` 50,000/-

With regard to disclosure of Excise Duty, explanation to paragraph 10 of AS 9, *Revenue Recognition*, specifically provides that the excise duty included in the turnover should be shown as reduction from the gross turnover on the face of the statement of profit and loss.

Ind AS 18, *Revenue*, does not specifically prescribe any guidance for presentation of excise duty. However, under Ind AS reporting framework, revenue from sale of products is presented by including the Excise Duty as discussed above. As per Division - II of Schedule III to the Companies Act, 2013 (i.e. Ind AS based Schedule III) – Note 3 of General Instructions for Preparation of Statement of Profit and Loss, provides that revenue from operations shall disclose separately in the notes:

- (a) sale of products (including Excise Duty);

- (b) sale of services; and
- (c) other operating revenues.

In view of above, since the revenue is the gross amount including excise duty, in the statement of profit and loss prepared under Ind AS, the excise duty should be reflected as an expense.

(ITFG Clarification Bulletin 4, Issue 1)
(Date of finalisation: August 19, 2016)

Whether an entity should adjust the consideration (including advance payments) for the effect of time value of money

Issue 103: On entering into contracts to supply goods and services, an entity requires advance payments from its customers. The period and effective interest rate between the date of receipt of the advance payment and the date that the entity transfers the risks and rewards of the goods and services to the customer are considered significant.

Whether the entity is required to adjust such advance payments received from a customer for goods or services to be provided over a long term for the effect of time value of money in accordance with Ind AS?

Response: Assuming that the contract established between the customer and the supplier does not contain a lease under Appendix C *Determining Whether an Arrangement contains a Lease* to Ind AS 17, and is not within the scope of Appendix C *Transfers of Assets from Customers* to Ind AS 18. Furthermore, the contract does not meet the definition of a derivative under Ind AS 109, *Financial Instruments*.

Paragraph 9 of Ind AS 18, *Revenue* requires entities to measure revenue 'at the fair value of the consideration received or receivable'.

Further, paragraph 11 of Ind AS 18, *inter-alia* provides that, 'In most cases, the consideration is in the form of cash or cash equivalents and the amount of revenue is the amount of cash or cash equivalents received or receivable. However, when the inflow of cash or cash equivalents is deferred, the fair value of the consideration may be less than the nominal amount of cash received or receivable. For example, an entity may provide interest-free credit to the buyer or accept a note receivable bearing a below-market interest rate from the buyer as consideration for the sale of goods. When the arrangement effectively constitutes a financing transaction, the fair value of the consideration is determined by discounting all future receipts using an imputed rate of interest.'

An analogy must be drawn from the above paragraph and accordingly, when the entity has received advance payments from the customer for providing promised goods or services, then it must evaluate whether the payment terms provide it with a significant benefit of financing. While making such an evaluation judgement is to be exercised and consideration be given to factors such as whether, the arrangement has been entered in the normal course of business, the advance payment is per typical payment terms within industry and having a primary purpose other than financing, it is a security for a future supply of limited goods or services or other relevant factors depending on facts and circumstances of each case [emphasis added]. If it is concluded that the arrangement does effectively constitute a significant financing component, i.e., a loan provided by the customer to the supplier for providing the promised goods, then the entity should adjust the consideration (including advance payments) for the effect of time value of money.

(ITFG Clarification Bulletin 14, Issue 3)

(Date of finalisation: February 1, 2018)

Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance

Accounting of below-market rate interest loan - exemption under para B10 of Ind AS 101

Issue 104 : (i) P Ltd., had obtained a below-market rate of interest loan of ₹ 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 ₹ 10,00,000 at the date of transition to Ind AS. The amount repayable will be ₹ 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.

*(ITFG Clarification Bulletin 12, Issue 7)
(Date of finalisation: October 23, 2017)*

Accounting treatment of exemption of custom duty under EPCG scheme

Issue 105: MNC Ltd. has received grant in the nature of exemption of custom duty on capital goods with certain conditions related to export of goods under Export Promotion Capital Goods (EPCG) scheme of Government of India. Whether the same is a government grant under Ind AS 20, Government Grants and Disclosure of Government Assistance? If yes, then whether it is a Grant related to asset or Grant related to income and how the same is to be accounted for?

Response: Paragraph 3 of Ind AS 20, Government Grants and Disclosure of Government Assistance, states as follows:

“3 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.”

In accordance with the above, in the given case exemption of custom duty under EPCG scheme is a government grant and should be accounted for as per the provisions of Ind AS 20.

Ind AS 20 defines grant related to assets and grants related to income as follows:

“Grants related to asset are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire long-term assets. Subsidiary conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held.

Grants related to income are government grants other than those related to assets.”

It is pertinent to note that the classification of the grant as related to asset or income will require exercise of judgement and careful examination of the facts, objective and conditions attached to the scheme of the government. Care is also required to ascertain the purpose of the grant and the costs for which the grant is intended to compensate.

Based on the evaluation of facts, if it is ascertained that the grant is an asset related grant then the same shall be presented as per paragraph 24 & 26 of Ind AS 20 which has been stated below:

Presentation of grants related to assets

24 Government grants related to assets, including non-monetary grants at fair value, shall be presented in the balance sheet by setting up the grant as deferred income.

26 The grant set up as deferred income is recognised in profit or loss on a systematic basis over the useful life of the asset.”

If it is determined that the grant is related to income then the same shall be presented as follows:

Presentation of grants related to income

29 Grants related to income are presented as part of profit or loss, either separately or under a general heading such as ‘Other income’; alternatively, they are deducted in reporting the related expense.

It may be further noted that as per paragraph 12 of Ind AS 20, government grants shall be accounted as follows:

“12 Government grants shall be recognised in profit or loss on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate

In the given case, if based on the terms and conditions of the scheme, the grant received is to compensate the import cost of assets subject to an export obligation as prescribed in the EPCG Scheme; recognition of grant in the statement of profit and loss should be linked to fulfilment of associated export obligations.

However, if the grant received is to compensate the import cost of the asset and based on the examination of the terms and conditions of the grant, if it can be reasonably concluded that conditions relating to export of goods are subsidiary conditions, then it is appropriate to recognise such grant in profit or loss over the life of the underlying asset.

(ITFG Clarification Bulletin 11, Issue 5)

(Date of finalisation: July 31, 2017)

Accounting treatment of the grants in the nature of promoters' contribution on the date of transition to Ind AS and post transition to Ind AS

Issue 106: ABC Co. is a government company and is a first-time adopter of Ind AS. As per the previous GAAP, the contributions received by ABC Co. from the government (which holds 100% shareholding in ABC Co.) which is in the nature of promoters' contribution have been recognised in capital reserve and treated as part of shareholders' funds in accordance with the provisions of AS 12, *Accounting for Government Grants*.

- 1) Whether the accounting treatment of the grants in the nature of promoters' contribution as per AS 12 is also permitted under Ind AS 20 *Accounting for Government Grants and Disclosure of Government Assistance*. If not, then what will be the accounting treatment of such grants recognised in capital reserve as per previous GAAP on the date of transition to Ind AS.
- 2) What will be the accounting treatment of the grants in the nature of promoters' contribution which ABC Co. receives post transition to Ind AS?

Response: 1) Paragraph 2 of Ind AS 20, *Accounting for Government Grants and Disclosure of Government Assistance*, *inter-alia*, states as follows:

“2 This Standard does not deal with:

(a) ...

(c) government participation in the ownership of the entity.”

In accordance with the above, it may be noted that Ind AS 20 specifically scopes out the participation by the government in the ownership of an entity.

In this fact pattern, Government has 100% shareholding in the entity. Accordingly, the entity needs to determine whether the payment is provided as a shareholder contribution or as a government. Equity contributions will be recorded in equity while grants will affect the statement of profit and loss.

Where it is concluded that the contributions are in the nature of government grant, the entity shall apply the principles of Ind AS 20 retrospectively as specified in Ind AS 101. Ind AS 20 requires all grants to be recognised as income on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate. Unlike AS 12, Ind AS 20 requires the grant to be classified as either a capital or an income grant and does not permit recognition of government grants in the nature of promoter's contribution directly to shareholders' funds.

Where it is concluded that the contributions are in the nature of shareholder contributions are recognised in capital reserve under previous GAAP, it is important to note the provisions of paragraph 10 of Ind AS 101, which states that:

“10 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.”

Accordingly, as per the above requirements of paragraph 10(c) in the given

case, contributions recognised in the Capital Reserve should be transferred to appropriate category under 'Other Equity' at the date of transition to Ind AS.

(2) The entity shall apply the same principles as mentioned above for accounting the contributions received by the entity subsequent to the transition date.

(ITFG Clarification Bulletin 9, Issue 3)

(Date of finalisation: May 15, 2017)

Accounting of grants related to non-depreciable assets considering the amendments made by the notification apply for the annual periods beginning on or after April 1, 2018

Issue 107: Ind AS 20, *Accounting for Government Grants and Disclosure of Government Assistance*, has recently been amended in certain respects and consequential amendments have been made to certain other Ind ASs vide notification dated 20th September, 2018 ('the notification') issued by the Ministry of Corporate Affairs, Government of India.

One of the amendments made to Ind AS 20 has the effect of allowing an entity to initially recognise a government grant in the form of a non-monetary asset either at a fair value or at a nominal amount. As per the pre-amended (or original) standard, such a grant was necessarily required to be initially recognised at fair value.

The amendments made by the notification apply for the annual periods beginning on or after April 1, 2018.

X Ltd., a government company having 100% of its paid-up capital held by the Government of India received land in the year 2008 from the government to construct and operate a mass rapid transit system (MRTS) in a metropolitan city. The land was received free of cost subject to compliance with specified terms and conditions. In accordance with AS 12, *Accounting for Government Grants*, the land was recorded at a nominal value of Re.1-.

In the following scenarios, at what amount will the aforesaid land be included in financial statements of X Ltd. in accordance with Ind AS 20?

- (i) X Ltd. is a first-time adopter of Ind ASs and its first Ind AS reporting period is financial year 2018-19.

- (ii) **X Ltd. is not a first time adopter of Ind ASs and financial year 2018-19 is its second (or third) reporting period under Ind ASs.**

Response: *[It may be noted that Ind AS 20 specifically scopes out the participation by the government in the ownership of an entity. In this fact pattern, Government of India has 100% shareholding in the entity, but it has been assumed that the land provided has been evaluated as not being in the nature of owners' contribution and hence, it is in the nature of a government grant as per Ind AS 20.*

Further, it has been assumed that the above arrangement has been evaluated as not being within the scope of Appendix D, Service Concession Arrangements of Ind AS 115, Revenue from Contracts with Customers or scope of Appendix A, Service Concession Arrangements of Ind AS 18, Revenue, as the case may be.]

Paragraph 18 of Ind AS 20 states that, "Grants related to non-depreciable assets may also **require the fulfilment of certain obligations and would then be recognised in profit or loss over the periods that bear the cost of meeting the obligations**. As an example, a grant of land may be conditional upon the erection of a building on the site and it may be appropriate to recognise the grant in profit or loss over the life of the building."

Further, paragraph 23 of Ind AS 20 relating to non-monetary government grants states the following:

*"A government grant may take the form of a transfer of a non-monetary asset, such as land or other resources, for the use of the entity. In these circumstances, **it is usual to assess the fair value of the non-monetary asset and to account for both grant and asset at that fair value**. An alternative course that is sometimes followed is to **record both asset and grant at a nominal amount**."*

- (i) **If X Ltd. is a first-time adopter of Ind AS for the reporting period 2018-19**

Ind AS 101, *First-time Adoption of Indian Accounting Standards*, contains requirements applicable to first Ind AS financial statements of an entity and the relevant provisions in the above context are as follows:

Paragraph 3 of Ind AS 101 states the following:

"An entity's first Ind AS financial statements are the first annual financial statements in which the entity adopts Ind ASs, in accordance with Ind ASs notified under the Companies Act, 2013 and makes an

explicit and unreserved statement in those financial statements of compliance with Ind ASs.”

In accordance with the above, the financial statements of X Ltd for the financial year 2018-19 are its first Ind AS financial statements.

Ind AS 101 further states the following-:

“Opening Ind AS Balance Sheet

- 6 *An entity shall prepare and present an opening Ind AS Balance Sheet at the date of transition to Ind ASs. This is the starting point for its accounting in accordance with Ind ASs subject to the requirements of paragraphs D13AA and D22.*
- 7 *An entity shall use the same accounting policies in its opening Ind AS Balance Sheet and throughout all periods presented in its first Ind AS financial statements. Those accounting policies shall comply with each Ind AS effective at the end of its first Ind AS reporting period, except as specified in paragraphs 13–19 and Appendices B–D.*
- 8 *An entity shall not apply different versions of Ind ASs that were effective at earlier dates. An entity may apply a new Ind AS that is not yet mandatory if that Ind AS permits early application.”*

Accordingly, X Ltd is required to apply the amended Ind AS 20 for all periods presented in its financial statements for 2018-19, including in preparing its opening Ind AS balance sheet as at April 1, 2017.

Further, as can be seen from above requirements of Ind AS 101, the general requirement in Ind AS 101 is that accounting policies followed in the opening Ind AS balance sheet and in reporting other periods included in first Ind AS financial statements should comply with all Ind ASs that are effective at the end of the first Ind AS reporting period. Generally, those accounting policies are applied on a retrospective basis. However, as a departure from this general requirement, Ind AS 101 provides certain mandatory exceptions and voluntary exemptions from retrospective application of some aspects/requirements of other Ind ASs. Ind AS 101 does not contain any mandatory exceptions or voluntary exemptions from retrospective application of Ind AS 20. Consequently, X Ltd is required to apply the requirements of Ind AS 20, retrospectively at the date of transition to Ind ASs (and consequently in subsequent accounting periods).

It is pertinent to note that under the amended Ind AS 20, X Ltd has a choice of recognising the grant and the asset (i.e., land in the given case), initially either at fair value or at a nominal amount.

(ii) If X Ltd. is not a first-time adopter of Ind AS and financial year 2018-19 is its second (or third) Ind AS reporting period

Financial year 2018-19 is the second (or third) Ind AS reporting period of X Ltd. Consequently, Ind AS 101 does not apply in preparing the financial statements for the financial year 2018-19.

In the previous financial year, in accordance with the pre-amended standard, X Ltd followed the accounting policy of recognising the land and the government grant initially at fair value by setting up the grant as deferred income to be recognised in profit or loss on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grant is intended to compensate. Hence, the financial statements of X Ltd for the financial year 2017-18 already include the land and the grant, both measured in accordance with the accounting policy as stated above.

It is to be noted that the amended Ind AS 20 provides a choice to entities to recognise the grant and related asset initially either at fair value or at a nominal amount. The issue is whether, in view of the amended Ind AS 20 being applicable for the financial year 2018-19, X Ltd is required or permitted to change its aforesaid accounting policy in preparing the financial statements for the year 2018-19.

The requirements relating to changes in accounting policies are primarily contained in Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*.

Paragraph 19 of Ind AS 8 states as follows:

Applying changes in accounting policies

19 Subject to paragraph 23:

- (a) *an entity shall account for a change in accounting policy resulting from the initial application of an Ind AS in accordance with the specific transitional provisions, if any, in that Ind AS; and*
- (b) *when an entity changes an accounting policy upon initial application of an Ind AS that does not include specific transitional provisions applying to that change, or changes an accounting policy voluntarily, it shall apply the change retrospectively.*

The amended Ind AS 20 does not contain any specific transitional provisions. Accordingly, X Ltd. has to apply the change retrospectively, if it is permitted by Ind AS 8, and decides to voluntarily change its accounting policy (from fair value to nominal amount).

As regards circumstances in which an accounting policy should, or can, be changed, paragraphs 14-15 of Ind AS 8 state the following:

“14 An entity shall change an accounting policy only if the change:

- (a) is required by an Ind AS; or*
- (b) results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.*

15 Users of financial statements need to be able to compare the financial statements of an entity over time to identify trends in its financial position, financial performance and cash flows. Therefore, the same accounting policies are applied within each period and from one period to the next unless a change in accounting policy meets one of the criteria in paragraph 14.”

It may be noted that the amended Ind AS 20 provides an entity a choice between recognising the grant and the asset initially either at fair value or at a nominal amount. Thus, X Ltd is not required to change the accounting policy relating to the grant as applied by it in preparing its financial statements for the previous financial year. The issue then is whether X Ltd. can change its accounting policy voluntarily.

A change in accounting policy other than a change required by an Ind AS can be made by an entity only if it is permitted to do so under paragraph 14(b) of Ind AS 20. According to paragraph 14(b), a voluntary change in an accounting policy can be made only if the change “results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.” Thus, paragraph 14 lays down two requirements that must be complied with in order to make a voluntary change in an accounting policy. First, the information resulting from application of the changed (i.e., the new) accounting policy must be reliable. Second, the changed accounting policy must result in “more relevant” information being presented in the financial statements.

Whether a changed accounting policy results in reliable and more relevant financial information is a matter of assessment in the particular facts and circumstances of each case. In order to ensure that such an assessment is made judiciously (such that a voluntary change in an accounting policy does

not effectively become a matter of free choice), paragraph 29 of the standard requires an entity making a voluntary change in an accounting policy to disclose, *inter alia*, “the reasons why applying the new accounting policy provides reliable and more relevant information”.

In accordance with the above, a voluntary change in accounting policy by X Ltd can be made only if the change results in the financial statements providing *reliable and more relevant information* about the effects of transactions, other events or conditions on its financial position, financial performance or cash flows.

(ITFG Clarification Bulletin 17, Issue 1)

(Date of finalisation: December 19, 2018)

Accounting of benefits received to SEZ/STP unit

Issue 108: MNC Ltd. is a registered SEZ/STP unit which receives benefits in the form of exemption from payment of taxes and duties on import/export of goods upon fulfilment of certain conditions under a scheme of Government of India. Whether the benefit being received by MNC Ltd. is a government grant or a government assistance other than government grant under Ind AS 20, *Government Grants and Disclosure of Government Assistance*? If it is a government grant, whether it is a grant related to asset or grant related to income and how is the same to be accounted for.

Response: Paragraph 3 of Ind AS 20, *Government Grants and Disclosure of Government Assistance*, states as follows:

“3 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 paragraph 9 of Ind AS 20 states that, *“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 accordance with the above, in the given case, the benefit of exemption from payment of taxes and duties levied by the government is a government grant and should be accounted for as per the provisions of Ind AS 20.

It is pertinent to note that the classification of the grant as related to an asset or to income will require exercise of judgement and careful examination of the facts, objective and conditions attached to the scheme. The purpose of the grant and the costs for which the grant is intended to compensate would also be required to be ascertained carefully.

The guidance given under ITFG Clarification Bulletin 11 (Issue 5) may also be referred in making this assessment.

*(ITFG Clarification Bulletin 17, Issue 3)
(Date of finalisation: December 19, 2018)*

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

Determination of functional currency and presentation currency for preparation of annual financial statements in case of Group

Issue 109: Company X, which is incorporated in India is the wholly-owned subsidiary of Company Y. In accordance with the principles of Ind AS 21 *The Effects of Changes in Foreign Exchange Rates*, Company X has ascertained its functional currency to be USD. Company X has subsidiaries and joint ventures outside India and prepares both standalone as well as consolidated financial statements. The functional currency of the parent company, i.e. Company Y continues to be ₹. Company Y will require Company X to provide its annual consolidated financial statements presented in ₹ for consolidation and reporting at ultimate parent level.

Whether Company X would present its annual financial statements as per Ind AS in its functional currency (i.e. USD) or in the functional currency of the parent company (₹)? Further, whether statutory auditors of Company X will provide their audit report on financial statements prepared in ₹ or financial statements prepared in USD?

Response:

As per paragraph 17 of Ind AS 21, “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. The entity translates foreign currency items into its functional currency and reports the effects of such translation in accordance with paragraphs 20–37 and 50.”

Paragraph 21 of Ind AS 21 states that, “A foreign currency transaction shall be recorded, on initial recognition in the functional currency, by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of the transaction.”

In accordance with the above, it may be noted that each entity is required to determine its functional currency in accordance with Ind AS 21 and is required to translate foreign currency items into functional currency.

Further, Paragraph 18 of Ind AS 21 states as follows:

“Many reporting entities comprise a number of individual entities (e.g. a group is made up of a parent and one or more subsidiaries). Various types of entities, whether members of a group or otherwise, may have investments in associates or joint arrangements. They may also have branches. It is necessary for the results and financial position of each individual entity included in the reporting entity to be translated into the currency in which the reporting entity presents its financial statements. This Standard permits the presentation currency of a reporting entity to be any currency (or currencies). The results and financial position of any individual entity within the reporting entity whose functional currency differs from the presentation currency are translated in accordance with paragraphs 38–50.”

Paragraphs 38 & 39 of Ind AS 21 are stated below:

- “38 An entity may present its financial statements in any currency (or currencies). If the presentation currency differs from the entity’s functional currency, it translates its results and financial position into the presentation currency. For example, when a group contains individual entities with different functional currencies, the results and financial position of each entity are expressed in a common currency so that consolidated financial statements may be presented.*
- 39 The results and financial position of an entity whose functional currency is not the currency of a hyperinflationary economy shall be translated into a different presentation currency using the following procedures:*
- (a) assets and liabilities for each balance sheet presented (i.e. including comparatives) shall be translated at the closing rate at the date of that balance sheet;*
 - (b) income and expenses for each statement of profit and loss presented (i.e. including comparatives) shall be translated at exchange rates at the dates of the transactions; and*
 - (c) all resulting exchange differences shall be recognised in other comprehensive income.”*

In accordance with the above paragraphs, it may be noted that entities within a group may have different functional currencies. Further, as Ind AS does not prohibit the use of any currency as presentation currency, an entity may

present its financial statements in any currency by applying the translation procedures from functional to presentation currency as stated above.

Accordingly, in the given case, if Company X is statutorily required to present its financial statements in ` , which is different from its functional currency, i.e. USD, then it may do so by choosing the ` as presentation currency and prepare and present its financial statements by applying the provisions of paragraphs 38 and 39 of Ind AS 21.

As Company X is statutorily required to present its financial statements in ` , the auditor of Company X will be required to give audit report on financial statements prepared in ` .

(ITFG Clarification Bulletin 7, Issue 2)

(Date of finalisation: March 30, 2017)

Identification of functional currency of an entity

Issue 110: 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 (“`”), 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 ` .

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 ` . 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.

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

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.

(ITFG Clarification Bulletin 3, Issue 3)

(Date of finalisation: June 22, 2016)

Ind AS 23, Borrowing Costs

Capitalisation of Dividend Distribution Tax (DDT) as borrowing costs of the qualifying asset

Issue 111: Can Dividend Distribution Tax (DDT) paid on distribution of dividend to preference shareholders (that are classified as liability as per Ind AS 32, *Financial Instruments: Presentation*), be capitalised as borrowing costs with the qualifying asset in accordance with the principles of Ind AS 23, *Borrowing Costs*?

Response: Paragraphs 5 and 6 of Ind AS 23, *Borrowing Costs*, state as follows:

“5 Borrowing costs are interest and other costs that an entity incurs in connection with the borrowing of funds.

6 Borrowing costs may include:

(a) interest expense calculated using the effective interest method as described in Ind AS 109, Financial Instruments; (b)”

With regard to the recognition of dividend declared on financial instruments, paragraphs 35 and 36 of Ind AS 32 reproduced hereunder may be noted:

“35 Interest, dividends, losses and gains relating to a financial instrument or a component that is a financial liability shall be recognised as income or expense in profit or loss. Distributions to holders of an equity instrument shall be recognised by the entity directly in equity. Transaction costs of an equity transaction shall be accounted for as a deduction from equity.

36 The classification of a financial instrument as a financial liability or an equity instrument determines whether interest, dividends, losses and gains relating to that instrument are recognised as income or expense in profit or loss. Thus, dividend payments on shares wholly recognised as liabilities are recognised as expenses in the same way as interest on a bond. Similarly, gains and losses associated with redemptions or refinancings of financial liabilities are recognised in profit or loss, whereas redemptions or refinancings of equity instruments are recognised as changes in equity. Changes in the fair value of an equity instrument are not recognised in the financial statements.”

In view of the above, if a financial instrument is classified as debt, the

dividend or interest thereon is in the nature of interest which is charged to profit or loss.

Further, paragraph 8 of Ind AS 23 states that, *“An entity shall capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. An entity shall recognise other borrowing costs as an expense in the period in which it incurs them.”*

Paragraphs B5.4.4 and B5.4.8 of Ind AS 109, *Financial Instruments*, state as follows:

“B5.4.4 When applying the effective interest method, an entity generally amortises any fees, points paid or received, transaction costs and other premiums or discounts that are included in the calculation of the effective interest rate over the expected life of the financial instrument....”

The Guidance Note on Ind AS Schedule III provides following guidance in respect of dividend on redeemable preference shares:

Dividend on preference shares, whether redeemable or convertible, is of the nature of ‘Interest expense’, only where there is no discretion of the issuer over the payment of such dividends. In such case, the portion of dividend as determined by applying the effective interest method should be presented as ‘Interest expense’ under ‘Finance cost’. Accordingly, the corresponding Dividend Distribution Tax on such portion of non-discretionary dividends should also be presented in the Statement of Profit and Loss under ‘Interest expense’.

In the given case, assuming that the requirements of paragraph 8 of Ind AS 23 for capitalisation are met then the dividend on the preference shares that are classified as a liability, in accordance with the principles of Ind AS 32, *Financial Instruments: Presentation* would be treated as interest and DDT paid thereon will be treated as cost eligible for capitalisation. Thus, in the given case, DDT is in the nature of incremental cost that an entity incurs in connection with obtaining the funds for qualifying asset. Hence DDT should be capitalised along with interest. Further, dividend distribution tax paid on such dividend will form part of the effective interest rate calculation (EIR) to compute the effective interest expense to be capitalised with the qualifying asset.

*(ITFG Clarification Bulletin 13, Issue 1)
(Date of finalisation: January 16, 2018)*

Capitalising of the processing fees as borrowing costs when the loans are specifically borrowed for the purpose of a qualifying asset

Issue 112: As per Ind AS 23, *Borrowing Costs*, an entity shall capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. An entity shall recognise other borrowing costs as an expense in the period in which it incurs them.

When the loans are specifically borrowed for the purpose of a qualifying asset and the processing charges incurred thereon have been incurred by the company, then whether the entire processing charges needs to be capitalised to the cost of the qualifying asset or the processing charges to the extent amortised up to the period of capitalisation needs to be capitalised?

Response: As per paragraph 6 of Ind AS 23, *Borrowing Costs*, borrowing costs includes interest expense calculated using the effective interest method as described in Ind AS 109, *Financial Instruments*.

Appendix A of Ind AS 109, *Financial Instruments*, defines 'Effective interest method' as, the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset or to the amortised cost of a financial liability. When calculating the effective interest rate, an entity shall estimate the expected cash flows by considering all the contractual terms of the financial instrument (for example, prepayment, extension, call and similar options) but shall not consider the expected credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate (see paragraphs B5.4.1–B5.4.3), transaction costs, and all other premiums or discounts. There is a presumption that the cash flows and the expected life of a group of similar financial instruments can be estimated reliably. However, in those rare cases when it is not possible to reliably estimate the cash flows or the expected life of a financial instrument (or group of financial instruments), the entity shall use the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments).

Paragraph B5.4.1 of Ind AS 109, *Financial Instruments*, states as follows:

“In applying the effective interest method, an entity identifies fees that are an integral part of the effective interest rate of a financial instrument. The description of fees for financial services may not be indicative of the nature and substance of the services provided. Fees that are an integral

part of the effective interest rate of a financial instrument are treated as an adjustment to the effective interest rate, unless the financial instrument is measured at fair value, with the change in fair value being recognised in profit or loss. In those cases, the fees are recognised as revenue or expense when the instrument is initially recognised."

Further, paragraph B5.4.2 of Ind AS 109, *inter-alia*, states that, "*fees that are an integral part of the effective interest rate of a financial instrument include:*

(c) 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. An entity distinguishes fees and costs that are an integral part of the effective interest rate for the financial liability from origination fees and transaction costs relating to the right to provide services, such as investment management services."

In accordance with the above, the processing fee is an integral part of the effective interest rate of a financial instrument and shall be included while calculating the effective interest rate. Accordingly, the processing charges to the extent amortised only up to the period of capitalisation of the qualifying asset can be capitalised.

(ITFG Clarification Bulletin 14, Issue 1)
(Date of finalisation: February 1, 2018)

Ind AS 24, Related Party Disclosures

Whether sitting fees paid to independent director and Non-executive director is required to be disclosed in the financial statements prepared as per Ind AS

Issue 113: Whether sitting fees paid to independent director and Non-executive director is required to be disclosed in the financial statements prepared as per Ind AS?

Response: As per paragraph 9 of Ind AS 24, *Related Party Disclosures*, “Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.”

In accordance with the above definition, key management personnel (KMP) includes any director of the entity who are having authority and responsibility for planning, directing and controlling the activities of the entity. Accordingly, independent and non-executive directors are also covered under the definition of KMP in accordance with Ind AS.

Paragraph 17 of Ind AS 24 requires the following disclosures about employee benefits for key management personnel:

“An entity shall disclose key management personnel compensation in total and for each of the following categories:

- (a) short-term employee benefits;*
- (b) post-employment benefits;*
- (c) other long-term benefits;*
- (d) termination benefits; and*
- (e) share-based payment.”*

Further, paragraph 7 and 9 of Ind AS 19, *Employee Benefits*, states that-

*“7 An employee may provide services to an entity on a full-time, part-time, permanent, casual or temporary basis. For the purpose of this Standard, **employees include directors and other management personnel.**”*

“9 Short-term employee benefits include items such as the following, if

expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related services:

- (a) *wages, salaries and social security contributions;*
- (b) *paid annual leave and paid sick leave;*
- (c) *profit-sharing and bonuses; and*
- (d) *non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees.”*

In accordance with the above provisions, non- executive directors meeting this criteria are covered under the definition of key management personnel. The sitting fees paid to directors will fall under the definition of “Short-term employee benefits” as per Ind AS 19 and is required to be disclosed in accordance with the paragraph 17 of Ind AS 24.

(ITFG Clarification Bulletin 11, Issue 9)

(Date of finalisation: July 31, 2017)

Related Party Disclosures in case of holding and subsidiary company (electricity distribution company)

Issue 114: S Ltd., a wholly owned subsidiary of P Ltd is the sole distributor of electricity to consumers in a specified geographical area. A manufacturing facility of P Ltd is located in the said geographical area and, accordingly, P Ltd is also a consumer of electricity supplied by S Ltd. The electricity tariffs for the geographical area are determined by an independent rate-setting authority and are applicable to all consumers of S Ltd, including P Ltd.

Whether the above transaction is required to be disclosed as a related party transaction as per Ind AS 24, Related Party Disclosures in the financial statements of S Ltd.?

Response: As per paragraph 9(b)(i) of Ind AS 24, each parent, subsidiary and fellow subsidiary in a ‘group’ is related to the other members of the group. Thus, in the case under discussion, P Ltd is a related party of S Ltd from the perspective of financial statements of S Ltd.

Paragraph 11 of Ind AS 24 states as follows:

“In the context of this Standard, the following are not related parties:

- (a) *two entities simply because they have a director or other member of*

key management personnel in common or because a member of key management personnel of one entity has significant influence over the other entity.

- (b) *two joint venturers simply because they share joint control of a joint venture.*
- (c)
 - (i) *providers of finance,*
 - (ii) *trade unions,*
 - (iii) *public utilities, and*
 - (iv) *departments and agencies of a government that does not control, jointly control or significantly influence the reporting entity,*

simply by virtue of their normal dealings with an entity (even though they may affect the freedom of action of an entity or participate in its decision-making process). [Emphasis added]

- (d) *a customer, supplier, franchisor, distributor or general agent with whom an entity transacts a significant volume of business, simply by virtue of the resulting economic dependence.”*

Being engaged in distribution of electricity, S Ltd is a public utility. Had the only relationship between S Ltd and P Ltd been that of a supplier and a consumer of electricity, P Ltd would not have been regarded as a related party of S Ltd. However, as per the facts of the given case, this is not the only relationship between S Ltd and P Ltd. Apart from being a supplier of electricity to P Ltd., S Ltd is also a subsidiary of P Ltd; this is a relationship that is covered within the related party relationships to which the disclosure requirements of the standard apply.

In view of the above, the supply of electricity by S Ltd to P Ltd is a related party transaction that attracts the disclosure requirements contained in paragraph 18 and other relevant requirements of the standard. This is notwithstanding the fact that P Ltd is charged the electricity tariffs determined by an independent rate-setting authority (i.e., the terms of supply to P Ltd are at par with those applicable to other consumers) – Ind AS 24 does not exempt an entity from disclosing related party transactions merely because they have been carried out on an arm's length basis.

(ITFG Clarification Bulletin 17, Issue 6)
(Date of finalisation: December 19, 2018)

Ind AS 27, Separate Financial Statements

Post Ind AS adoption accounting treatment of profit share from investment in limited liability partnership which is under joint control (in separate financial statements)

Issue 115: Company A Ltd. has equity investment in a Limited Liability Partnership (LLP). Company A Ltd. has joint control over the LLP and assessed that investment in LLP is a joint venture. How investment in LLP be accounted for in the separate financial statements of Company A Ltd? Whether profit share from LLP will be adjusted to the carrying amount of the investment in LLP in the separate financial statements of Company A Ltd.?

Response: Paragraph 26 of Ind AS 111, *Joint Arrangements*, prescribes the accounting treatment for investment in joint arrangements in separate financial statement of joint operator or joint venture as follows:

“26 In its separate financial statements, a joint operator or joint venturer shall account for its interest in:

- (a) a joint operation in accordance with paragraph 20-22;**
- (b) a joint venture in accordance with paragraph 10 of Ind AS 27, Separate Financial Statements.”**

Paragraph 10 of Ind AS 27, *Separate Financial Statements*, *inter alia*, provides that 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 the given case, Company A Ltd. has joint control over the LLP and has assessed that investment in LLP is a joint venture. Accordingly, the entity shall account for its investment in the joint venture in its separate financial statements as per paragraph 10 of Ind AS 27, i.e. at cost or in accordance with Ind AS 109. Therefore, adjustment of profit share from LLP to the carrying amount of the investment in LLP in its separate financial statements is not permitted.

The accounting of return on investment (i.e. profit share from LLP) will depend on the terms of contract between Company A Ltd. and LLP. The share in profit in LLP shall be recognised as income in the statement of profit and loss as and when the right to receive its profit share is established.

(ITFG Clarification Bulletin 5, Issue 8)

(Date of finalisation: September 19, 2016)

Measurement of investment in subsidiaries at cost if valued at fair value on date of transition

Issue 116: 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.

(ITFG Clarification Bulletin 3, Issue 12)
(Date of finalisation: June 22, 2016)

Ind AS 28, Investment in Associates and Joint Ventures

Treatment of adjustments arising out of fair valuation of investment property in the consolidated financial statements of the investor

Issue 117: Company B, a subsidiary of Company A (parent) owns an investment property that is measured at cost in accordance with Ind AS 40, *Investment Property*. Company A sells a portion of its equity shareholding in Company B, as a result of which Company B becomes a joint venture between Company A and Company Z. As per the requirements of Ind AS 28, equity method is required to be applied in the consolidated financial statements of Company A to account for its investment in the joint venture (i.e., Company B).

Ind AS 40, *Investment Property*, does not allow an investment property to be measured at fair value. On the other hand, in applying the equity method in consolidated financial statements of the investor, as per Ind AS 28, identifiable assets and liabilities of the investee are required to be fair valued and appropriate adjustments are required to be made to entity's share of investee's profit or loss, such as those for depreciation/ amortisation based on aforesaid fair values at acquisition date.

- (i) Whether there is any contradiction between Ind AS 40 and Ind AS 28?
- (ii) Also, whether the adjustments arising out of fair valuation of investment property as required under Ind AS 28 should be made in the consolidated financial statements of the investor?

Response:

- (i) While the above issue has been raised in the context of a situation where a former subsidiary becomes a joint venture and the investee owns an investment property that is measured at cost in accordance with Ind AS 40, it has a wider applicability, e.g., a similar issue also arises when an investor

makes an investment that gives rise to a parent-subsidiary or an investor-joint venture or an investor-associate relationship between the investor and the investee.

Ind ASs require the application of a mixed measurement model in preparing the balance sheet of an entity – some assets and liabilities are measured at fair value while other assets and liabilities are measured on a different basis (or bases) such as historical cost. Besides, Ind ASs prohibit the recognition of certain assets such as internally-generated goodwill and brands.

From the perspective of an investor who acquires, say, a controlling interest in an entity (or an interest giving the investor joint control or significant influence over the investee), Ind ASs require the investor to identify whether it has made a bargain purchase gain or whether the consideration includes an element of payment for goodwill. The amount of any bargain purchase gain or of any payment for goodwill can be appropriately determined only with reference to the fair values of the identifiable assets and liabilities of the investee as at the acquisition date and not with reference to their book values as at that date. Accordingly, the relevant standard (e.g., Ind AS 28 in the case of a joint venture or an associate) requires determination of fair values of identifiable assets and liabilities of the investee for this purpose. This does not *per se* indicate a contradiction between 28 (or Ind AS 110 in case of acquisition of a controlling interest) on the one hand and the standards that require a cost-based measurement in the balance sheet of the investee on the other.

Therefore, there does not seem any contradiction between Ind AS 40 and Ind AS 28.

(ii) As per paragraph 25 of Ind AS 110, *Consolidated Financial Statements*, if a parent loses control of a subsidiary, it recognises any investment retained in the former subsidiary at its fair value when control is lost. Such fair value is regarded as the cost on initial recognition of an investment in a joint venture (or an associate).

Paragraph 32 of Ind AS 28, *Investments in Associates and Joint Ventures* states as under:

*“An investment is accounted for using the equity method from the date on which it becomes an associate or a joint venture. On acquisition of the investment, any difference between the cost of the investment and the **entity’s share of the net fair value** of the investee’s identifiable assets and liabilities is accounted for as follows:*

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- (a) *Goodwill relating to an associate or a joint venture is included in the carrying amount of the investment. Amortisation of that goodwill is not permitted.*
- (b) *Any excess of the entity's share of the net fair value of the investee's identifiable assets and liabilities over the cost of the investment is recognised directly in equity as capital reserve in the period in which the investment is acquired.*

*Appropriate adjustments to the entity's share of the associate's or joint venture's profit or loss after acquisition are made in order to account, for example, **for depreciation of the depreciable assets based on their fair values at the acquisition date**. Similarly, appropriate adjustments to the entity's share of the associate's or joint venture's profit or loss after acquisition are made for impairment losses such as for goodwill or property, plant and equipment."*(Emphasis added)

In accordance with the above, on acquisition of the investment, any difference between the cost of the investment and the **entity's share of the net fair value of the investee's identifiable assets** and liabilities is recognised in the manner stated above. The fair value of identifiable assets and liabilities are considered to be the cost of the assets and liabilities for the investor to the extent of its share in the investee. Accordingly, appropriate adjustments arising out of fair valuation of assets/liabilities impacting profit or loss should be made in the consolidated financial statements of Company A.

*(ITFG Clarification Bulletin 17, Issue 5)
(Date of finalisation: December 19, 2018)*

Ind AS 32, Financial Instruments: Presentation

Computation of financial liability in case of convertible debentures sharing same coupon rate and market rate

Issue 118: A company ABC Limited has issued compulsorily convertible debentures at 14.5 % coupon rate which will be converted at the end of 10 years. The unsecured loan market rate of interest is 14.5% (Assuming this rate can be considered as the appropriate market rate for the given purpose). Coupon rate on debentures is same as that of the market rate of interest although coupon rate on instruments with conversion feature is generally lower than market rate of interest on unsecured loans. How the financial liability (debt portion) would be computed in such situation. (It is assumed that the equity conversion option requires the company to deliver a fixed number of its own shares for a fixed amount of another financial asset indicating that it meets the 'fixed for fixed' criterion under Ind AS 32).

Response: As per Ind AS 32, *Financial Instruments: Presentation*, in case of compound financial instruments, it is required to separate it into two components, i.e., financial liability (debt) and equity component. When allocating the initial carrying amount of the compound instrument to the underlying financial liability and equity component, an entity first determine the fair value of the liability component (assuming there is no embedded derivative). The fair value of the liability component is determined with reference to the fair value of a similar stand-alone debt instrument. The amount allocated to the equity component is residual amount after deducting the fair value of the financial liability component from the fair value of the entire compound instrument.

The application guidance of Ind AS 32 provides additional guidance on compound financial instruments from issuers' point of view.

AG31 A common form of compound financial instrument is a debt instrument with an embedded conversion option, such as a bond convertible into ordinary shares of the issuer, and without any other embedded derivative features. Paragraph 28 requires the issuer of such a financial instrument to present the liability component and the equity component separately in the balance sheet, as follows:

- (a) *The issuer's obligation to make scheduled payments of interest and principal is a financial liability that exists as long as the instrument is not converted. On initial recognition, the fair value of the liability component is the present value of the contractually determined stream of future cash flows discounted at the rate of interest applied at that time by the market to instruments of comparable credit status and providing substantially the same cash flows, on the same terms, but without the conversion option.*
- (b) *The equity instrument is an embedded option to convert the liability into equity of the issuer. This option has value on initial recognition even when it is out of the money.*

Basis above guidance, the fair value of the liability shall be the present value of the contractually determined stream of future cash flows discounted at the rate of interest applied at that time by the market to instruments of comparable credit status and providing substantially the same cash flows, on the same terms, but without the conversion option. The amount allocated to the equity component will be the residual amount after deducting the fair value of the financial liability component as determined above from the fair value of the entire compound instrument (for purpose of this issue, transaction costs have been ignored).

(ITFG Clarification Bulletin 13, Issue 10)

(Date of finalisation: January 16, 2018)

Treatment of dividend on financial instruments declared after the end of the reporting period

Issue 119: ABC Ltd. has declared dividend on a financial instrument (which has been classified as a liability in accordance with Ind AS 32, *Financial Instruments: Presentation*), after the end of the reporting period. Whether ABC Ltd. is required to accrue such dividends in the financial statements for the year even if it is declared after the end of the reporting period?

Response:

Assuming ABC Ltd. has correctly classified the financial instrument as financial liability as per Ind AS 32, then it shall account for dividend in accordance with the following provisions of paragraph 35 of Ind AS 32:

"35 Interest, dividends, losses and gains relating to a financial instrument

or a component that is a financial liability shall be recognised as income or expense in profit or loss. Distributions to holders of an equity instrument shall be recognised by the entity directly in equity. Transaction costs of an equity transaction shall be accounted for as a deduction from equity.”

Further, paragraph 12 of Ind AS 10 states that, ‘*If an entity declares dividends to holders of equity instruments after the reporting period, the entity shall not recognise those dividends as a liability at the end of the reporting period.*’

It may also be noted that the above paragraph of Ind AS 10 applies only to those financial instruments which are classified as equity instruments. The payment of dividend/interest to financial instruments classified as liability accrues at the end of the reporting period even if it is paid or declared after the end of the reporting period. Accordingly, in the given case, ABC Ltd. is required to account for the dividend, even if it is declared after the end of the reporting period.

Further, accounting for dividend on financial instrument which is classified as financial liability is governed by classification of such instrument under Ind AS 109. If it is classified as subsequently measured at Amortised Cost, dividend will be accrued as part of interest expense recognised based on effective interest method.

*(ITFG Clarification Bulletin 7, Issue 6)
(Date of finalisation: March 30, 2017)*

Treatment of optionally convertible preference shares in Standalone financial statements and consolidated financial statements

Issue 120: A holding company H Ltd., which is covered under phase II of Ind AS has a subsidiary S Ltd. H Ltd. is holding 57% of equity in S Ltd. The subsidiary S Ltd., has issued 1.5% optionally convertible preference shares to its holding company, which are non-cumulative. All preference shares are issued to holding company. The subsidiary company has the option to convert or redeem the stated preference shares. H Limited does not have any right for the redemption of such preference shares. How will these instruments be accounted for in the following financial statements:

- (i) Stand-alone financial statements of S Ltd;

(ii) **Stand-alone financial statements of H Ltd; and**

(iii) **Consolidated financial statements of the Group.**

Response: It has been assumed that S Ltd. has an option to convert the instrument into a fixed number of its own shares and dividend payment is discretionary.

Paragraph 16 of Ind AS 32, *Financial Instruments: Presentation*, *inter alia*, states that, “when an issuer applies the definitions in paragraph 11 to determine whether a financial instrument is an equity instrument rather than a financial liability, the instrument is an equity instrument if, and only if, both conditions (a) and (b) below are met.

(a) *The instrument includes no contractual obligation:*

- (i) *to deliver cash or another financial asset to another entity; or*
- (ii) *to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the issuer.*

(b) *If the instrument will or may be settled in the issuer’s own equity instruments, it is:*

- (i) *a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or*
- (ii) *a derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments. For this purpose, rights, options or warrants to acquire a fixed number of the entity’s own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro-rata to all of its existing owners of the same class of its own non-derivative equity instruments. Apart from the aforesaid, the equity conversion option embedded in a convertible bond denominated in foreign currency to acquire a fixed number of the entity’s own equity instruments is an equity instrument if the exercise price is fixed in any currency. Also, for these purposes the issuer’s own equity instruments do not include instruments that have all the features and meet the conditions described in paragraphs 16A and 16B or paragraphs 16C and 16D, or*

instruments that are contracts for the future receipt or delivery of the issuer's own equity instruments."

(i) Provided the conversion feature is considered substantive, the instrument can be viewed as an equity instrument, because the issuer has the ability to convert the instrument into a fixed number of its own shares at any time. The issuer, therefore, has the ability to avoid making a cash payment or settling the instrument in a variable number of its own shares. Any feature that might have been considered to be an embedded derivative would not meet the definition of a derivative on a stand-alone basis, given the ability to avoid payment. Hence, the issuer's conversion and redemption options would not be separated, and the entire instrument would be classified as equity in the separate financial statements of S Ltd.

(ii) In the separate financial statements of H Limited, the investment should be considered to be an investment in subsidiary and therefore would be excluded from the scope of Ind AS 109 unless H Ltd has elected otherwise.

Paragraph 10 of Ind AS 27, *Separate Financial Statements*, states that 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 view of the above assuming that the company H Ltd. has not elected to account for its investment in accordance with Ind AS 109, it would account for it at cost.

(iii) In the consolidated financial statements of the Group, these transactions will be eliminated, being intra-group transactions in accordance with Ind AS 110.

(ITFG Clarification Bulletin 14, Issue 7)
(Date of finalisation: February 01, 2018)

Accounting of Foreign Currency Convertible Bonds (FCCB)

Issue 121: Company PQR Ltd is required to comply with Ind AS from financial year 2017-18. It had issued Foreign Currency Convertible Bonds (FCCB) at the rate of 6% interest rate on April 26, 2013 to a foreign Investor (bondholder). The tenure of the FCCB is five years and one day. As per the terms and conditions, the FCCB would be converted into equity on April 26, 2018 at the option of the holder On

the settlement day, the Company will issue the fixed number of shares, e.g. 100,000 shares. Interest on the FCCB is payable on a half yearly basis, which has been paid on regular basis.

To comply with the relevant RBI norms, the FCCB issued by the company were at the maximum permissible interest rate on the date of issuance, say, 6%. However, based on the guidance under Ind AS company has assessed that the applicable rate after considering, currency, time period, credit status and without conversion option for borrowing would have been, assuming 7.5%.

What should be the rate of interest at which the liability portion of the FCCB be discounted to determine the present value of financial liability at initial recognition?

Response: As per paragraph 28 of Ind AS 32, *Financial Instruments, Presentation*, “The issuer of a non-derivative financial instrument shall evaluate the terms of the financial instrument to determine whether it contains both a liability and an equity component. Such components shall be classified separately as financial liabilities, financial assets or equity instruments in accordance with paragraph 15.”

Paragraph 29 *inter-alia* states that, An entity recognises separately the components of a financial instrument that (a) creates a financial liability of the entity and (b) grants an option to the holder of the instrument to convert it into an equity instrument of the entity. For example, a bond or similar instrument convertible by the holder into a fixed number of ordinary shares of the entity is a compound financial instrument. From the perspective of the entity, such an instrument comprises two components: a financial liability (a contractual arrangement to deliver cash or another financial asset) and an equity instrument (a call option granting the holder the right, for a specified period of time, to convert it into a fixed number of ordinary shares of the entity).

As per the requirements of Ind AS 32, FCCB is a compound financial instrument (fixed for fixed met as per Ind AS requirement) and the issuer of the compound financial instruments is required to split the instrument into two components i.e. one as liability and other as equity component on initial recognition. It may be noted that in accordance with paragraph 11(b) (ii) of Ind AS 32, the equity conversion option embedded in a convertible bond denominated in foreign currency to acquire a fixed number of the entity's own equity instruments is an equity instrument with the exercise price is fixed in any currency.

Paragraph AG31 of Ind AS 32 states as follows:

AG31 A common form of compound financial instrument is a debt instrument with an embedded conversion option, such as a bond convertible into ordinary shares of the issuer, and without any other embedded derivative features. Paragraph 28 requires the issuer of such a financial instrument to present the liability component and the equity component separately in the balance sheet, as follows:

- (a) The issuer's obligation to make scheduled payments of interest and principal is a financial liability that exists as long as the instrument is not converted. On initial recognition, the fair value of the liability component is the present value of the contractually determined stream of future cash flows discounted at the rate of interest applied at that time by the market to instruments of comparable credit status and providing substantially the same cash flows, on the same terms, but without the conversion option.*
- (b) The equity instrument is an embedded option to convert the liability into equity of the issuer. This option has value on initial recognition even when it is out of the money.*

In accordance with the above, the recognition and measurement requirements of Ind AS 32 require the issuer to account the compound financial instruments in the following manner:

- The liability portion of the FCCB would be measured at the fair value by determining the net present value of all contractually determined future cash flows under the instrument, discounted at the market rate of interest prevailing at the time of issue. The discount rate for this should be comparable to the instrument for aspects, such as, currency, time period, credit status and cash flows, but without the conversion option.
- The equity component is the residual amount after deducting the liability component from the fair value of the compound instrument.

Accordingly, in the given case, the company should discount the future cash flows at 7.5% to determine the financial liability for initial recognition. Difference between fair value of financial liability and transaction value would be accounted as equity as per the guidance under Ind AS.

It may be noted that the response is based on the limited facts and circumstances and is only for accounting purpose. The commercial substance of the transaction and other regulatory aspects such as the

requirements of Companies Act, 2013 for declaration of dividend will be required to be evaluated separately.

(ITFG Clarification Bulletin 15, Issue 1)

(Date of finalisation: April; 04, 2018)

Accounting treatment of the preference shares and dividends

Issue 122 : ABC Limited has issued non-cumulative compulsorily redeemable preference shares. Redemption is in cash after 10 years, dividend @ 6%. The market rate of interest is @ 4%. Preference shares have been issued to an unrelated party. During the term of the instrument, dividends are payable at the discretion of ABC Ltd. The instrument is a compound financial instrument as per the requirements of Ind AS 32 *Financial Instruments, Presentation*.

What will be the accounting treatment of the preference shares and dividends which are at the discretion of ABC Ltd. and the same have not yet been declared by ABC Ltd.

Response: Paragraphs 31 and AG 37 of Ind AS 32 state as follows:

*31 Ind AS 109 deals with the measurement of financial assets and financial liabilities. Equity instruments are instruments that evidence a residual interest in the assets of an entity after deducting all of its liabilities. Therefore, **when the initial carrying amount of a compound financial instrument is allocated to its equity and liability components, the equity component is assigned the residual amount after deducting from the fair value of the instrument as a whole the amount separately determined for the liability component.** The value of any derivative features (such as a call option) embedded in the compound financial instrument other than the equity component (such as an equity conversion option) is included in the liability component. The sum of the carrying amounts assigned to the liability and equity components on initial recognition is always equal to the fair value that would be ascribed to the instrument as a whole. No gain or loss arises from initially recognising the components of the instrument separately.*

*AG37 The following example illustrates the application of paragraph 35 to a compound financial instrument. Assume that a non-cumulative preference share is mandatorily redeemable for cash in five years, but that dividends are payable at the discretion of the entity before the redemption date. **Such an instrument is a compound financial instrument, with the liability***

component being the present value of the redemption amount. The unwinding of the discount on this component is recognised in profit or loss and classified as interest expense. Any dividends paid relate to the equity component and, accordingly, are recognised as a distribution of profit or loss. A similar treatment would apply if the redemption was not mandatory but at the option of the holder, or if the share was mandatorily convertible into a variable number of ordinary shares calculated to equal a fixed amount or an amount based on changes in an underlying variable (eg commodity). However, if any unpaid dividends are added to the redemption amount, the entire instrument is a liability. In such a case, any dividends are classified as interest expense.

In accordance with the above, the non-cumulative redeemable preference shares are compound financial instruments since the payment of dividend to preference shareholders is with the discretion of the issuer, i.e. ABC Ltd. Accordingly, on initial recognition, the fair value of the instrument will be bifurcated into liability and equity component. The fair value of the liability component on initial recognition is determined as the present value of the eventual redemption amount discounted at the market rate of return. The equity component is the residual amount, i.e. the difference between the present value of the liability component and fair value of the instrument as a whole.

Furthermore, any discretionary dividends will be recognised when they are actually declared and paid and will relate to the equity component and accordingly, are recognised as a distribution of profit or loss

It may be noted that the response is based on the limited facts and circumstances and is only for accounting purpose. The commercial substance of the transaction and other regulatory aspects such as the requirements of Companies Act, 2013 for declaration of dividend will be required to be evaluated separately.

*(ITFG Clarification Bulletin 15, Issue 2)
(Date of finalisation: April; 04, 2018)*

Classification of preference shares denominated in its functional currency and carrying conversion-vs-redemption option

Issue 123: Entity K issues at par preference shares denominated in its functional currency and carrying discretionary non-cumulative dividend of 12% per annum. As per terms of the issue, a holder of preference

shares has an option to convert each preference share into a fixed number of equity shares of the entity at the end of 5 year from the date of issue, failing which the preference shares will be redeemed at their par amount. The conversion-vs-redemption option is available independently for each preference share held by a holder. Additionally, throughout the five-year period, a holder of a preference share can put the same back to the entity for its par amount at any time. Issuance of preference shares on these terms is permissible in the relevant jurisdiction. Transaction costs are negligible.

How would the above preference shares be classified (i.e., whether as a liability or as equity) in the financial statements of Entity K?

Response: Ind AS 32, *Financial Instruments: Presentation* lays down the principles for classification of financial instruments, from the perspective of the issuer.

Paragraph 15 of Ind AS 32 states the following:

“The issuer of a financial instrument shall classify the instrument, or its component parts, on initial recognition as a financial liability, a financial asset or an equity instrument in accordance with the substance of the contractual arrangement and the definitions of a financial liability, a financial asset and an equity instrument.”

Paragraphs 28 to 32 of Ind AS 32 deal with the classification of compound financial instruments, i.e., instruments that contain both liability and equity components and state the following:

- “28 *The issuer of a non-derivative financial instrument shall evaluate the terms of the financial instrument to determine whether it contains both a liability and an equity component. Such components shall be classified separately as financial liabilities, financial assets or equity instruments in accordance with paragraph 15.*
- 29 *An entity recognises separately the components of a financial instrument that (a) creates a financial liability of the entity and (b) grants an option to the holder of the instrument to convert it into an equity instrument of the entity. For example, a bond or similar instrument convertible by the holder into a fixed number of ordinary shares of the entity is a compound financial instrument. From the perspective of the entity, such an instrument comprises two components: a financial liability (a contractual arrangement to deliver cash or another financial asset) and an equity instrument (a call option granting the holder the*

right, for a specified period of time, to convert it into a fixed number of ordinary shares of the entity). The economic effect of issuing such an instrument is substantially the same as issuing simultaneously a debt instrument with an early settlement provision and warrants to purchase ordinary shares, or issuing a debt instrument with detachable share purchase warrants. Accordingly, in all cases, the entity presents the liability and equity components separately in its balance sheet.

- 30 *Classification of the liability and equity components of a convertible instrument is not revised as a result of a change in the likelihood that a conversion option will be exercised, even when exercise of the option may appear to have become economically advantageous to some holders. Holders may not always act in the way that might be expected because, for example, the tax consequences resulting from conversion may differ among holders. Furthermore, the likelihood of conversion will change from time to time. The entity's contractual obligation to make future payments remains outstanding until it is extinguished through conversion, maturity of the instrument or some other transaction.*
- 31 *Ind AS 109 deals with the measurement of financial assets and financial liabilities. Equity instruments are instruments that evidence a residual interest in the assets of an entity after deducting all of its liabilities. Therefore, when the initial carrying amount of a compound financial instrument is allocated to its equity and liability components, the equity component is assigned the residual amount after deducting from the fair value of the instrument as a whole the amount separately determined for the liability component. The value of any derivative features (such as a call option) embedded in the compound financial instrument other than the equity component (such as an equity conversion option) is included in the liability component. The sum of the carrying amounts assigned to the liability and equity components on initial recognition is always equal to the fair value that would be ascribed to the instrument as a whole. No gain or loss arises from initially recognising the components of the instrument separately.*
- 32 *Under the approach described in paragraph 31, the issuer of a bond convertible into ordinary shares first determines the carrying amount of the liability component by measuring the fair value of a similar liability (including any embedded non-equity derivative features) that does not have an associated equity component. The carrying amount of the equity instrument represented by the option to convert the instrument*

into ordinary shares is then determined by deducting the fair value of the financial liability from the fair value of the compound financial instrument as a whole.”

In accordance with the above, Entity K would first determine the carrying amount of the liability component by measuring the fair value of a similar liability (including any embedded non-equity derivative features) that does not have an associated equity component. The carrying amount of the equity component ((i.e., the holder’s option to convert the instrument into affixed number of equity shares and the holder’s right to receive any dividends declared on the preference shares would then be determined by deducting the fair value of the financial liability from the fair value of the compound financial instrument as a whole.

As regards the fair value of the liabilities with a demand feature, paragraph 47 of Ind AS 113, *Fair Value Measurement*, states the following:

“The fair value of a financial liability with a demand feature (eg a demand deposit) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.”

In the given case, as per the terms and conditions of issue of the preference shares, Entity K has a contractual obligation to pay the par amount to the holder of a preference share at any point of time (i.e., the instrument contains a financial liability with a demand feature.

Therefore, in accordance with the above, the whole of the issue price of preference shares is allocated to the liability component and no amount is assigned to the equity component.

*(ITFG Clarification Bulletin 17, Issue 9)
(Date of finalisation: December 19, 2018)*

Classification of financial instrument in case of rights offer

Issue 124: Entity X, whose functional currency is INR, has two classes of (non-puttable) equity shares, Class A and Class B. On May 1, 2018, the entity makes a rights offer to all holders of Class B equity shares. As per the rights offer, for each one equity share of Class B held by a shareholder, the shareholder is entitled to subscribe to 100 equity shares of Class A. The rights offer price is fixed at INR 60 per Class A share for Indian shareholders, and USD 1 per Class A share for overseas shareholders, holding Class B equity shares. The rights offer is valid for 6 months.

Whether the rights offer to Class B shareholders to acquire Class A shares, as referred to in the above paragraph, is an equity instrument or a (derivative) financial liability from the perspective of Entity X?

Response: Ind AS 32, *Financial Instruments: Presentation* lays down the principles for the classification of financial instruments as financial assets, financial liabilities or equity instruments from the issuer's perspective.

As per paragraph 11 of Ind AS 32, "A financial liability is any liability that is:

- (a) a contractual obligation :
 - (i) to deliver cash or another financial asset to another entity; or
 - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or
- (b) a contract that will or may be settled in the entity's own equity instruments and is:
 - (i) a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or
 - (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. **For this purpose, rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments.** Apart from the aforesaid, the equity conversion option embedded in a convertible bond denominated in foreign currency to acquire a fixed number of the entity's own equity instruments is an equity instrument if the exercise price is fixed in any currency. Also, for these purposes the entity's own equity instruments do not include puttable financial instruments that are classified as equity instruments in accordance with paragraphs 16A and 16B, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 16C and 16D, or instruments that are contracts for

the future receipt or delivery of the entity's own equity instruments. As an exception, an instrument that meets the definition of a financial liability is classified as an equity instrument if it has all the features and meets the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D. [Emphasis added]"

In the given case, the position regarding compliance with the aforementioned conditions laid down in Ind AS 32 for equity classification of a rights offer is as follows -

- (i) *Is the rights offer for acquiring a fixed number of the entity's own equity instruments?*

Yes, the rights offer is for acquiring a fixed number of the entity's own equity instruments, i.e., for each one equity share of Class B held by a shareholder, the shareholder is entitled to subscribe to 100 equity shares of Class A.

- (ii) *Is the rights exercise price a fixed amount of any currency?*

Yes, the rights exercise price is fixed at INR 60 per share for Indian shareholders and USD 1 per share for overseas shareholders.

- (iii) *Has the entity offered the rights pro rata to all of its existing owners of the same class of its own non-derivative equity instruments?*

Yes, Entity X has made the rights offer to all of the existing holders of its Class B equity shares (non-derivative equity instruments) pro-rata to their holding of Class B equity shares.

As all the conditions for equity classification are met, the rights offer to Class B shareholders to acquire Class A shares is classified by Entity X as an equity instrument.

*(ITFG Clarification Bulletin 17, Issue 10)
(Date of finalisation: December 19, 2018)*

Classification of financial instrument in case of equity conversion option forming part of terms of issue of preference shares

Issue 125: Entity Y, whose functional currency is INR, has issued a certain number of preference shares to an overseas investor. According to the terms of issue of the preference shares, at the end of three years from the date of issue, the holder has the option to either redeem each

preference share for cash payment of USD 10 or to get 3 equity shares of Entity Y in lieu of each preference share.

Whether the equity conversion option forming part of terms of issue of preference shares represents an equity instrument or a (derivative) financial liability of Entity Y?

Response: Ind AS 32, *Financial Instruments: Presentation* lays down the principles for the classification of financial instruments as financial assets, financial liabilities or equity instruments from the issuer's perspective.

As per paragraph 11 of Ind AS 32, "A financial liability is any liability that is:

- (a) a contractual obligation :
 - (i) to deliver cash or another financial asset to another entity; or
 - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or
- (b) a contract that will or may be settled in the entity's own equity instruments and is:
 - (i) a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or
 - (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose, rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments. **Apart from the aforesaid, the equity conversion option embedded in a convertible bond denominated in foreign currency to acquire a fixed number of the entity's own equity instruments is an equity instrument if the exercise price is fixed in any currency.** Also, for these purposes the entity's own equity instruments do not include puttable financial instruments that are classified as equity instruments in accordance with paragraphs 16A and 16B, instruments that impose on the entity an obligation to

deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 16C and 16D, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments. As an exception, an instrument that meets the definition of a financial liability is classified as an equity instrument if it has all the features and meets the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D. [Emphasis added]"

As per the above definition, as a general principle, a derivative is a financial liability if it will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. The term 'fixed amount of cash' refers to an amount of cash fixed in functional currency of the reporting entity. Since, an amount fixed in a foreign currency has the potential to vary in terms of functional currency of the reporting entity due to exchange rate fluctuations, it does not represent "a fixed amount of cash". However, as an exception to the above general principle, Ind AS 32 regards **the equity conversion option embedded in a convertible bond** denominated in a foreign currency to acquire a fixed number of entity's own equity instruments to be an equity instrument if the exercise price is fixed in *any* currency, i.e., whether fixed in functional currency of the reporting entity or in a foreign currency. [It may be noted that the corresponding standard under IFRSs (viz., IAS 32) does not contain this exception].

Ind AS 32 makes the above exception only in the case of an equity conversion option embedded in a convertible bond denominated in a foreign currency, even though it explicitly recognises at several places that other instruments can also contain equity conversion options. Given this position, it does not seem that the above exception can be extended by analogy to equity conversion options embedded in other types of financial instruments denominated in a foreign currency such as preference shares.

In view of the above, the equity conversion option forming part of terms of issue of preference shares under discussion would be a (derivative) financial liability of Entity Y.

*(ITFG Clarification Bulletin 17, Issue 11)
(Date of finalisation: December 19, 2018)*

Ind AS 33, Earnings per Share

Presentation of earning per share for separate and consolidated financial statements

Issue 126: Paragraph 9 of Ind AS 33, *Earnings per Share* states that, “An entity shall calculate basic earnings per share amounts for profit or loss attributable to ordinary equity holders of the parent entity and, if presented, profit or loss from continuing operations attributable to those equity holders.”

Does this mean that a subsidiary company, not wholly owned, should present EPS only for the portion of the profit which is attributable to the parent entity?

Response: Paragraph 4 of Ind AS 33 states as follows:

“4 When an entity presents both consolidated financial statements and separate financial statements prepared in accordance with Ind AS 110, Consolidated Financial Statements, and Ind AS 27, Separate Financial Statements, respectively, the disclosures required by this Standard shall be presented both in the consolidated financial statements and separate financial statements. In consolidated financial statements such disclosures shall be based on consolidated information and in separate financial statements such disclosures shall be based on information given in separate financial statements. An entity shall not present in consolidated financial statements, earnings per share based on the information given in separate financial statements and shall not present in separate financial statements, earnings per share based on the information given in consolidated financial statements.”

In accordance with the above an entity is required to disclose EPS in both its Stand-alone Financial Statements (SFS) and in Consolidated Financial Statements (CFS) (if presented by the entity).

Paragraph 9 states that an entity shall calculate basic earnings per share amounts for profit or loss attributable to ordinary equity holders of the parent entity and, if presented, profit or loss from continuing operations attributable to those equity holders.

Further, paragraph A1 of Appendix A of Ind AS 33 also states that, “For the purpose of calculating earnings per share based on the consolidated

financial statements, profit or loss attributable to the parent entity refers to profit or loss of the consolidated entity after adjusting for non- controlling interests.”

It is pertinent to note that the requirements of paragraph 9 of Ind AS 33 have been provided in the context of calculating EPS in the consolidated financial statements of an entity.

However, analogy may be drawn from paragraph 9 of Ind AS 33 that in case of separate financial statements, the parent entity mentioned in paragraph 9 will imply the legal entity of which separate financial statements are being prepared and accordingly, when an entity presents EPS in its separate financial statements, then the same shall be calculated based on the profit or loss attributable to its equity shareholders.

(ITFG Clarification Bulletin 11, Issue 3)

(Date of finalisation: July 31 2017)

Treatment of Foreign Currency Monetary Item Translation Difference Account for the purpose of calculation of basic earnings per share (EPS)

Issue 127: MNC Ltd. is a first-time adopter of Ind AS. It had availed the option given under paragraph 46/46A of AS 11, *The Effects of Changes in Foreign Exchange Rates* notified under the Companies (Accounting Standards) Rules, 2006. MNC Ltd. has opted for the exemption given under paragraph D13AA of Ind AS 101, *First-time Adoption of Indian Accounting Standards* and accordingly, debited exchange differences arising from translation of long term foreign currency monetary items to Foreign Currency Monetary Item Translation Difference Account.

Whether the amount debited to Foreign Currency Monetary Item Translation Difference Account is required to be reduced from profit or loss from continuing operations for the purpose of calculating basic earnings per share (EPS) as per paragraph 12 of Ind AS 33, *Earnings per Share*?

Response: Paragraph 12 of Ind AS 33 states as follows:

“For the purpose of calculating basic earnings per share, the amounts attributable to ordinary equity holders of the parent entity in respect of:

- (a) profit or loss from continuing operations attributable to the parent entity; and*

(b) *profit or loss attributable to the parent entity*

shall be the amounts in (a) and (b) adjusted for the after-tax amounts of preference dividends, differences arising on the settlement of preference shares, and other similar effects of preference shares classified as equity.

Where any item of income or expense which is otherwise required to be recognised in profit or loss in accordance with Indian Accounting Standards is debited or credited to securities premium account/other reserves, the amount in respect thereof shall be deducted from profit or loss from continuing operations for the purpose of calculating basic earnings per share.”

In accordance with the above, it is pertinent to note that the above paragraph refers to those items of income or expense which as per Ind AS would have been required to be recognised in profit or loss but are recognised in securities premium account/other reserves.

Accordingly, the exchange differences arising from translation of long term foreign currency monetary items that are debited to Foreign Currency Monetary Translation Reserve Account as per paragraph 46/46A of AS 11 is an option available under Ind AS.

Accordingly, exchange differences that are being debited to Foreign Currency Monetary Item Translation Difference Account is in accordance with Ind AS and therefore, the same is not required to be reduced from profit or loss from continuing operations for the purpose of calculating basic earnings per share.

*(ITFG Clarification Bulletin 10, Issue 5)
(Date of finalisation: July 05, 2017)*

Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets

Whether provision for unspent Corporate Social Responsibility expenditure is required to be made as per Ind AS

Issue 128: Whether provision for unspent Corporate Social Responsibility expenditure is required to be made as per Ind AS?

Response: Paragraph 14 of Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets* states:

“A provision shall be recognised when:

- (a) an entity has a present obligation (legal or constructive) as a result of a past event;*
- (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and*
- (c) a reliable estimate can be made of the amount of the obligation.*

If these conditions are not met, no provision shall be recognised.”

Section 135 (5) of the Companies Act, 2013 (the Act) requires a company to spend a certain amount as expenditure towards Corporate Social Responsibility (CSR). The proviso to section 135 (5) of the Act provides that if the specified amount is not spent by the company during the year, the Directors' Report should disclose the reasons for not spending the amount.

In accordance with the above, it may be noted that provision for the amount which is not spent, i.e., any shortfall in the amount that was expected to be spent as per the provisions of the Act on CSR activities and the amount actually spent at the end of a reporting period, may not be required in the financial statements.

However, if a company has already undertaken certain CSR activity for which an obligation has been created, for example, by entering into a contractual obligation, or either a constructive obligation has arisen during the year, then in accordance with Ind AS 37, a provision for the amount of such CSR obligation, needs to be recognised in the financial statements.

(ITFG Clarification Bulletin 8, Issue 1)

(Date of finalisation: May 5, 2017)

Ind AS 38, Intangible Assets

Applicability of revenue based amortisation for intangible assets arising service concession arrangements in respect of toll roads for new arrangements entered after the date of transition

Issue 129: 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 amortisation 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.

(ITFG Clarification Bulletin 3, Issue 13)

(Date of finalisation: June 22, 2016)

Schedule III

Disclosure of operating profit on the face of Statement of Profit and Loss in accordance with Ind AS based Schedule III

Issue 130: Can a company disclose operating profit on the face of Statement of Profit and Loss in accordance with Ind AS based Schedule III?

Response: As per Ind AS based Schedule III, aggregate of 'Revenue from operations' and 'Other income' is to be disclosed on face of the Statement of Profit and Loss. Revenue from operations is to be separately disclosed in the notes, showing revenue from:

- (a) Sale of products (including Excise Duty);
- (b) Sale of services; and
- (c) Other operating revenues

The aggregate of 'Other income' is to be disclosed on face of the Statement of Profit and Loss. As per Note 5 of General Instructions for the Preparation of Statement of Profit and Loss 'Other Income' shall be classified as:

- (a) interest Income;
- (b) dividend Income; and
- (c) other non-operating income (net of expenses directly attributable to such income).

Paragraph 9.1.8 of the Guidance Note on Ind AS based Schedule III, states that, *"The term "other operating revenue" is not defined. This would include Revenue arising from a company's operating activities, i.e., either its principal or ancillary revenue-generating activities, but which is not revenue arising from sale of products or rendering of services. Whether a particular income constitutes "other operating revenue" or "other income" is to be decided based on the facts of each case and detailed understanding of the company's activities."*

Accordingly, disclosure of income shall be governed as stated above. Further it is also pertinent to note that Ind AS Schedule III sets out the minimum requirements for disclosure in the financial statements including notes. It states that line items, sub-line items and sub- totals shall be presented as an addition or substitution on the face of the financial statements when such

presentation is relevant to the understanding of the company's financial position or performance or to cater to industry/sector-specific disclosure requirements, apart from, when required for compliance with amendments to the Act or Ind AS.

As per the Guidance Note on Ind AS based Schedule III, the application of the above requirement is a matter of professional judgement. The following examples illustrate this requirement. Earnings before Interest, Tax, Depreciation and Amortisation is often an important measure of financial performance of the company relevant to the various users of financial statements and stakeholders of the company. Hence, a company may choose to present the same as an additional line item on the face of the Statement of Profit and Loss. The method of computation adopted by companies for presenting such measures should be followed consistently over the years. Further, companies should also disclose the policy followed in the measurement of such line items.

In respect of operating profit disclosure, certain items which are credited to profit and loss account may not form part of operating profit measure and therefore giving a separate line item for disclosure of the operating profit may not be appropriate and would result in change in the format of Statement of Profit and Loss as prescribed by Schedule III applicable to Ind AS companies. It is also to be noted that Ind AS Schedule III and Ind AS requires classification of expense by nature and not function. The operating profit measure sub-total would result in a more appropriate presentation of performance for entities classifying expenses by function. Since classification of expenses by function is not permitted under Ind AS and Ind AS Schedule III, it may not be appropriate to present an operating profit measure sub-total as part of the statement of profit and loss. However, the entity may provide such additional information in the financial statements.

(ITFG Clarification Bulletin 13, Issue 5)

(Date of finalisation: January 16, 2018)

Applicability of Ind AS based Schedule III on voluntary adoption of Ind AS

Issue 131: 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.

*(ITFG Clarification Bulletin 3, Issue 1)
(Date of finalisation: June 22, 2016)*

Classification of interest leviable on the entity due to delay in payment of the taxes in the statement of profit and loss

Issue 132: ABC Ltd. is required to pay certain taxes levied by a local authority. In case of delay in payment of taxes, interest is leviable at the rate of 1%, 2%, 3%, per month on the amount in default, depending upon the length of period of delay. Whether interest leviable on the entity due to delay in payment of the taxes would form part of finance cost or whether it would be classified as part of 'other expenses', in the statement of profit and loss as per the requirements of relevant Ind ASs and/or those of Division II of Schedule III to the Companies Act 2013?

Response: As per Schedule III, Division II, Note 4 of the General Instructions for the Preparation of the Statement of Profit and Loss, the finance costs shall be classified as-

- (a) Interest
- (b) Dividend on redeemable preference shares
- (c) Exchange differences regarded as an adjustment to borrowing costs
- (d) Other borrowing costs (specify nature)

In the given case, local taxes not paid by due date represent interest bearing liabilities. The entity would need to evaluate whether the interest payable for

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delay in payment of taxes is compensatory in nature for time value of money or penal in nature. This requires exercise of judgment based on evaluation of facts of the case.

Based on such evaluation, if it is concluded that interest is compensatory in nature then it shall be included in finance cost, if it is penal in nature, then it shall be classified under 'other expenses'.

(ITFG Clarification Bulletin 17, Issue 8)
(Date of finalisation: December 19, 2018)

APPENDICES

APPENDIX I

Frequently Asked Questions (FAQs) issued by the Accounting Standards Board of ICAI

FAQ on accounting treatment of increase in liability due to enhancement of the gratuity ceiling

This FAQ on accounting treatment of increase in liability on account of enhancement of the gratuity ceiling from ` 10 lakhs to ` 20 Lakhs due to Payment of Gratuity (Amendment) Act 2018 (vide notification no. S.O. 1420 (E) dated March 29, 2018) has been issued by the Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI). The purpose of this FAQ is to clarify the accounting treatment of increase in liability due to enhancement of the gratuity ceiling.

Question: ABC Ltd. is covered by the Payment of Gratuity Act, 1972 which is required to pay gratuity to its employees. Due to the recent amendment in the aforesaid Act there is substantial increase in the liability of the company. Whether there is any exemption or relief available to the company under Accounting Standards with regard to the accounting treatment of such increase in the liability.

Response: The Gratuity benefit is an employee benefit and accordingly any increase in company's liability due to enhancement of the gratuity ceiling from ` 10 Lakhs to ` 20 Lakhs would be accounted for as per the principles of AS 15, *Employee Benefits* or Ind AS 19, *Employee Benefits*, as the case may be.

In this regard, it may be noted that effect of above type of amendments need to be dealt with reference to accounting treatment of past service costs. The 'past service cost' is defined as below in AS 15 and Ind AS 19:

As per AS 15, "**Past service cost is the change in the present value of the defined benefit obligation for employee service in prior periods, resulting in the current period from the introduction of, or changes to, post-employment benefits or other long-term employee benefits. Past service cost may be either positive (where benefits are introduced or improved) or negative (where existing benefits are reduced)**".

As per Ind AS 19 “**past service cost, which is the change in the present value of the defined benefit obligation for employee service in prior periods, resulting from a plan amendment (the introduction or withdrawal of, or changes to, a defined benefit plan) or a curtailment (a significant reduction by the entity in the number of employees covered by a plan)**”.

As per the above, the increase in liability arising due to enhancement of gratuity ceiling from 10 to 20 Lakhs is a past service cost.

It may also be noted that the aforementioned accounting standards do not provide any exemption/one time relief with regard to the accounting treatment of increase in liability arising on account of past service cost. Accordingly, ABC Ltd. is required to account for any increase in the liability on account of increase in gratuity ceiling as expense as per the requirements of the relevant applicable Standard.

FAQ on utilisation of Securities Premium Account

Question: Company⁷ ABC Ltd. had issued non-convertible debentures redeemable at premium, which were outstanding as on March 31, 2015. The Company has measured this financial liability at amortised cost in accordance with Ind AS 109, *Financial Instruments*. In the past, the Company had utilised the Securities Premium Account for providing for the debenture redemption premium payable and writing off debenture issue expenses in view of the requirements of Section 78 of the Companies Act, 1956 and Section 52 of the Companies Act 2013 (such utilisation is not allowed once Ind AS becomes applicable).

As the amount of Securities Premium Account had been utilised to provide for debenture redemption premium payable and to write off debenture issue expenses, what retrospective accounting adjustments in this regard are required to be done in the books under Ind AS on transition date.

Response: Non-convertible debentures (financial liability) in the given case are classified as subsequently measured at amortised cost under Ind AS 109. Accordingly, Company ABC Ltd. will have to arrive at the amortised cost at the date of transition by applying the effective interest method (EIM) with retrospective effect from the date of issue of debentures. In view of requirements of Ind AS 109, amortised cost computation using EIM includes

⁷ This FAQ replaces the earlier Issue no. 7 of the Ind AS Transition Facilitation Group (ITFG) Clarification Bulletin 2 issued by the Accounting Standards Board.

all transaction costs that are directly attributable to the acquisition or issue of debentures, such as, expenses incurred on issue of debentures and premiums and discounts, if any.

In the above background, the Securities Premium Account utilised in past as described above, may result into higher carrying amount of non-convertible debentures as per Indian GAAP compared to amortised cost carrying amount required as per Ind AS 109 as on transition date and the excess amount needs to be reversed into an appropriate component of equity.

In this regard, the following requirement of Ind AS 101, *First-time Adoption of Indian Accounting Standards*, may be noted:

“11. The accounting policies that an entity uses in its opening Ind AS Balance Sheet may differ from those that it used for the same date using its previous GAAP. The resulting adjustments arise from events and transactions before the date of transition to Ind ASs. Therefore, an entity shall recognise those adjustments directly in retained earnings (or, if appropriate, another category of equity) at the date of transition to Ind ASs.”

In view of the above-mentioned requirement of Ind AS 101, it may be mentioned that the appropriate category of equity for reversal of the excess carrying amount of non-convertible debentures in this case is the Securities Premium Account. Accordingly, the excess of carrying value of financial liability as per Indian GAAP over the amortised cost amount arrived at by using EIM as per Ind AS 109 as on transition date should be reversed by crediting the Securities Premium Account with corresponding debit to the relevant account which was credited earlier.

FAQ on Dividend Distribution Tax

This FAQ on Dividend Distribution Tax has been issued by the Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI). The purpose of this FAQ is to illustrate and to assist in clarifying the requirements regarding treatment of Dividend Distribution Tax

Question: What are the presentation requirements as per Ind AS for dividend and dividend distribution tax thereon, if an entity has issued certain financial instruments that are classified as debt as per the provisions of Ind AS 32, *Financial Instruments: Presentation*? What would be the presentation requirements in this regard, if the financial instruments issued are classified as equity or if these are compound financial instruments and bifurcated into debt and equity?

Response: With regard to the recognition of dividend declared on financial instruments, paragraphs 35 and 36 of Ind AS 32 reproduced hereunder may be noted:

“35 Interest, dividends, losses and gains relating to a financial instrument or a component that is a financial liability shall be recognised as income or expense in profit or loss. Distributions to holders of an equity instrument shall be recognised by the entity directly in equity. Transaction costs of an equity transaction shall be accounted for as a deduction from equity.

36 The classification of a financial instrument as a financial liability or an equity instrument determines whether interest, dividends, losses and gains relating to that instrument are recognised as income or expense in profit or loss. Thus, dividend payments on shares wholly recognised as liabilities are recognised as expenses in the same way as interest on a bond. Similarly, gains and losses associated with redemptions or refinancings of financial liabilities are recognised in profit or loss, whereas redemptions or refinancings of equity instruments are recognised as changes in equity. Changes in the fair value of an equity instrument are not recognised in the financial statements.”

In view of the above, if a financial instrument is classified as debt, the dividend or interest paid thereon is in the nature of interest which is charged to profit or loss. Dividend or interest paid on a financial instrument which is classified as equity, should be recognised in the Statement of Changes in Equity. In case of a compound financial instrument, the dividend or interest allocated to debt portion shall be charged to profit or loss and the portion of dividend or interest pertaining to equity shall be recognised in Statement of Changes in Equity.

With regard to the income tax consequences of dividend, paragraphs 52A and 52B of Ind AS 12, *Income Taxes*, provide as under:

52A In some jurisdictions, income taxes are payable at a higher or lower rate if part or all of the net profit or retained earnings is paid out as a dividend to shareholders of the entity. In some other jurisdictions, income taxes may be refundable or payable if part or all of the net profit or retained earnings is paid out as a dividend to shareholders of the entity. In these circumstances, current and deferred tax assets and liabilities are measured at the tax rate applicable to undistributed profits.

52B In the circumstances described in paragraph 52A, the income tax consequences of dividends are recognised when a liability to pay the dividend is recognised. The income tax consequences of dividends are more directly linked to past transactions or events than to distributions to owners. Therefore, the income tax consequences of dividends are recognised in profit or loss for the period as required by paragraph 58 except to the extent that the income tax consequences of dividends arise from the circumstances described in paragraph 58(a) and (b).

Paragraph 52A deals with the aspect where income taxes are payable at a higher or lower rate if part or all of the net profit or retained earnings is paid out as a dividend to shareholders. However, as per paragraph 52B, income tax consequences of dividends are to be presented in profit or loss where it is linked to past transactions and events recognised. The ASB is of the view that in India the rate of income tax for company on taxable income does not change if a company distributes dividend. In India, the dividend distribution tax is a tax that is computed on the basis of the amount of dividend distributed to shareholders rather than based on the amount of profits earned and it arises at the point of time when the profits are distributed. Therefore, Indian scenario is different from the income tax consequences in other jurisdictions, which are covered by paragraph 52A of Ind AS 12.

In this context, following paragraph 65A of Ind AS 12, *Income Taxes*, as reproduced below may also be noted:

“65A When an entity pays dividends to its shareholders, it may be required to pay a portion of the dividends to taxation authorities on behalf of shareholders. In many jurisdictions, this amount is referred to as a withholding tax. Such an amount paid or payable to taxation authorities is charged to equity as a part of the dividends.”

In India, dividends are not taxable in the hands of shareholders considering that DDT is paid by the company that paid the dividend. Had there been no DDT mechanism, dividend would have been taxable in the hands of recipients, though recently it has been made taxable if the amount of dividend exceeds a specified limit. Therefore, in view of paragraph 65A, DDT is, in substance, of the nature of withholding tax. Therefore, the Board is of the view that the nature of payment of DDT in India is not similar to the scenario covered under the current paragraph 52A. Accordingly, the following paragraph of Ind AS 12, *Income Taxes* is relevant with regard to the presentation of dividend distribution tax paid:

“61A Current tax and deferred tax shall be recognised outside profit or loss

if the tax relates to items that are recognised, in the same or a different period, outside profit or loss. Therefore, current tax and deferred tax that relates to items that are recognised, in the same or a different period:

- (a) in other comprehensive income, shall be recognised in other comprehensive income.*
- (b) directly in equity, shall be recognised directly in equity.”*

In view of the above, presentation of on the dividends should be consistent with the presentation of the transaction that creates those income tax consequences. Therefore, DDT should be charged to profit or loss if the dividend itself is charged to profit or loss. If the dividend is recognised in equity, the presentation of DDT should be consistent with the presentation of the dividend, i.e., to be recognised in equity. Accordingly, in case of combined financial instruments, bifurcated into debt and equity, the portion of DDT related to dividend/interest to the debt component should be recognised in profit or loss and that related to equity component should be recognised in equity.

FAQ on Elaboration of terms ‘infrequent number of sales’ or ‘insignificant in value’ used in Ind AS 109

Question: Ind AS 109, *Financial Instruments*, requires an entity to classify financial assets on the basis of the entity’s business model for managing the financial assets. In this regard, under a business model whose objective is to hold assets in order to collect contractual cash flows, the Standard provides that for this purpose, it is necessary to consider the frequency, value and timing of sales in prior periods. Ind AS 109 appears to envisage sale of assets held under the amortised cost category before maturity, the application guidance of Ind AS 109 states that such sales may be consistent with a business model whose objective is to hold financial assets in order to collect contractual cash flows if those sales are infrequent (even if significant in value) or insignificant in value both individually and in aggregate (even if frequent).

In view of the above, the following may be clarified:

- (a) How should the terms ‘infrequent number of sales’ or ‘insignificant in value’ be interpreted and determined. Can indicative rebuttable thresholds be prescribed for sales that are more than insignificant in value?
- (b) What is the relation between the terms ‘immaterial’ and ‘insignificant’?

Response: Ind AS 109 does not define the terms 'infrequent number of sales' or 'insignificant in value'. However, these terms have been used in the Standard in the context of determination of business model. Under Ind AS 109, generally, sales which are 'infrequent in number' or 'insignificant in value' are considered to be consistent with a business model whose objective is to hold financial assets in order to collect contractual cash flows. The Standard does not lay down any thresholds for value or number in this regard.

However, the Standard provides detailed guidance on the hold to collect business model. In 2012, IASB had made limited amendments in IFRS 9 to clarify the objective of the hold to collect business model by providing additional application guidance. Ind AS 109 discusses various situations including credit risk where business model may be to hold assets to collect contractual cash flows even if the entity sells financial assets before maturity. Ind AS 109 provides that frequency and value of sales due to an increase in the assets' credit risk may not be inconsistent with a business model whose objective is to hold financial assets to collect contractual cash flows. Accordingly, while determining the business model, management may decide the situations in which sales of financial assets occurring before the maturity date may not be considered inconsistent with the entity's business model whose objective is to hold assets in order to collect contractual cash flows, e.g., an entity may lay down some criteria such as, if an entity sells a security which is initially rated as AAA security and subsequently, it is rated as BB, it will not be inconsistent with the entity's business model whose objective is to hold assets in order to collect contractual cash flows because the management may want to rebalance its portfolio by selling it rather than waiting till the maturity date. There can be other situations also depending upon the facts and circumstances which need to be judged by the management.

In this regard, apart from the guidance contained in the Standard, the Basis of Conclusions to IFRS 9 contains an additional instance in which sales of financial assets occurring before the maturity date may not be considered inconsistent with the entity's business model whose objective is to hold assets in order to collect contractual cash flows. The instance relates to change in the regulatory treatment of a particular type of financial asset which may cause an entity to undertake a significant rebalancing of its portfolio in a particular period.

In view of the above, following may be concluded:

- (a) On the reading of Ind AS 109 along with the Basis of Conclusions to IFRS 9, it can be concluded that it is a matter of judgement which should be assessed keeping in view the facts and circumstances pertaining to each case. Therefore, no rule of thumb in terms of even indicative percentage can be laid down to determine 'infrequent number of sales' or 'insignificant in value', since it may not be applicable in all cases considering the differing quantum, configuration and nature of financial assets in different entities. Hence, no indicative rebuttable thresholds can be prescribed for sales that are more than insignificant in value.
- (b) With regard to relation between terms 'immaterial' and 'insignificant', it may be noted that guidance on the term 'materiality' is already there in Ind AS which also does not lay down any criteria based on indicative fixed percentages. However, the term 'insignificant' has not been defined and can be interpreted to mean 'less than material' or almost 'negligible'.

FAQ on deemed cost of Property, Plant and Equipment under Ind AS 101, First-time Adoption of Indian Accounting Standards

Issue: Ind AS 101 provides that the net carrying amounts of all of its Property, Plant and Equipment as per previous GAAP can be used as deemed cost on the date of transition to Ind AS. In that case, whether the accumulated depreciation and provision for impairment under previous GAAP would be treated as nil on the date of transition. In case the response is in the affirmative, then how the provision for impairment provided before the date of transition as per previous GAAP would be reversed in later years if there is a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized?

Response:

In the context of the issue, the following paragraphs of Ind AS 101, *First-time Adoption of Indian Accounting Standards*, and the definition of 'deemed cost' contained in the Standard may be noted:

- "D5 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."
- "D7AA 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

Definition of Deemed Cost

“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.”

In view of the above, with regard to deemed cost, Ind AS 101, *inter alia*, provides an option to continue with the carrying value for all of its property, plant and equipment measured as per previous GAAP and use that as deemed cost on the date of transition. As per the definition of deemed cost, it is the amount used as a surrogate for the cost or depreciated cost and for the purpose of subsequent depreciation or amortisation, deemed cost becomes the cost as the starting point. Accordingly, from the date of transition, the deemed cost, i.e., carrying values of PPE as per the previous GAAP in the given case, is the cost and any accumulated depreciation and provision for impairment under previous GAAP have no relevance as would be the case if fair value were to be taken as deemed cost as per paragraph D5 above. Accordingly, provision for impairment provided before the date of transition as per previous GAAP cannot be reversed in later years.

However, information regarding gross block of assets, accumulated depreciation and provision for impairment under previous GAAP can be disclosed by way of note forming part of the financial statements. This information can be disclosed only as additional disclosures and the same cannot be considered for subsequent recognition and/or measurement purposes.

FAQs on requirements to prepare Consolidated Financial Statements

These FAQs on Consolidated Financial Statements have been issued by the Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI). The purpose of these FAQs is to illustrate and to assist in clarifying the requirements regarding preparation of Consolidated Financial Statements.

1.(i) Whether a company H Ltd is required to consolidate its subsidiary which is a Limited Liability Partnership (LLP) or a partnership firm?

(ii) Would the answer be different if LLP is an associate or joint venture of H Ltd?

(i) As per rule 6 of Companies (Accounts) Rules, 2014, under the heading 'Manner of consolidation of accounts' it is provided that consolidation of financial statements of a company shall be done in accordance with the provisions of Schedule III to the Companies Act, 2013 and the applicable Accounting Standards.

It is noted that relevant Indian Accounting Standard i.e., Ind AS 110, Consolidated Financial Statements provides that where an entity has control on one or more other entities, the controlling entity is required to consolidate all the controlled entities. Since, the word 'entity' includes a company as well as any other form of entity, therefore, LLPs and partnership firms are required to be consolidated. Similarly, under Accounting Standard (AS) 21, as per the definition of subsidiary, an enterprise controlled by the parent is required to be consolidated. The term 'enterprise' includes a company and any enterprise other than a company. Therefore, under AS also, LLPs and partnership firms are required to be consolidated.

Accordingly, in the given case, H Ltd is required to consolidate its subsidiary which is an LLP or a partnership firm.

(ii) If LLP or a partnership firm is an associate or joint venture of H Ltd, even then the LLP and the partnership firm need to be consolidated in accordance with the requirements of applicable Accounting Standards.

2. A Company H Ltd has no subsidiaries, but has investment in an associate and a joint venture. Whether H Ltd. is required to prepare consolidated financial statements for the year ending March 31, 2016, in the context of Companies (Accounting Standards) Rules, 2006.

Section 129 (3) of the Companies Act, 2013 provides that where a company has one or more subsidiaries, it shall prepare a consolidated financial statement of the company and of all the subsidiaries. Further, an Explanation to this sub section provides that the word "subsidiary" shall include associate company and joint venture.

In view of the above, in the given case, though H Ltd does not have any subsidiary, it is required to prepare consolidated financial statements for its

Appendix I: FAQs issued by ASB

associate and joint venture in accordance with the applicable Accounting Standards, viz, AS 23, Accounting for Investments in Associates in Consolidated Financial Statements and AS 27, *Financial Reporting of Interests in Joint Ventures*, respectively.

APPENDIX II

Extracts of Companies (Indian Accounting Standards) Rules 2015 read with Companies (Indian Accounting Standards) (Amendment) Rules, 2016

2. Definitions. - (1) In these rules, unless the context otherwise requires,-
- (a) “Accounting Standards” means the standards of accounting, or any addendum thereto for companies or class of companies as specified in rule 3;
 - (b) “Act” means the Companies Act, 2013 (18 of 2013);
 - (c) “Annexure” in relation to these rules means the Annexure containing the Indian Accounting Standards (Ind AS) appended to these rules;
 - (d) “entity” means a company as defined in clause (20) of section 2 of the Act;
 - (e) “financial statements” means financial statements as defined in clause (40) of section 2 of the Act;
 - (f) “net worth” shall have the meaning assigned to it in clause (57) of section 2 of the Act.
 - (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, Chit Companies, Securitisation and Reconstruction Companies, Mortgage Guarantee Companies, Pensions Fund Companies, Asset Management Companies and Core Investment Companies.
- (2) Words and expressions used herein and not defined in these rules but

Appendix II: Extracts of Companies (Ind AS) Rules

defined in the Act shall have the same meaning respectively assigned to them in the Act.

3. Applicability of Accounting Standards. - (1) The accounting standards as specified in the Annexure to these rules to be called the Indian Accounting Standards (Ind AS) shall be the accounting standards applicable to classes of companies specified in rule 4.

(2) The Accounting standards as specified in Annexure to the Companies (Accounting Standards) Rules, 2006 shall be the Accounting Standards applicable to the companies other than the classes of companies specified in rule 4.

(3) A company which follows the Indian Accounting Standards (Ind AS) specified in Annexure to these rules in accordance with the provisions of rule 4 shall follow such standards only.

(4) A company which follows the accounting standards specified in Annexure to the Companies (Accounting Standards) Rules, 2006 shall comply with such standards only and not the Standards specified in Annexure to these rules.

4. Obligation to comply with Indian Accounting Standards (Ind AS). -

(1) The Companies and their auditors shall comply with the Indian Accounting Standards (Ind AS) specified in Annexure to these rules in preparation of their financial statements and audit respectively, in the following manner, namely:-

- (i) 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;
- (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
- (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 sub-clause (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:
- (iv) Notwithstanding the requirement of clause (i) to (iii), Non-Banking Financial Companies (NBFCs) shall comply with the Indian Accounting Standards (Ind AS) in preparation of their financial statements and audit respectively, in the following manner, namely :-
 - (a) The following NBFCs shall company with the Indian Accounting Standards (Ind AS) for accounting periods beginning on or after the 1st April, 2018, with comparatives for the periods ending on 31st March, 2018, or thereafter-
 - (A) NBFCs having net worth of rupees five hundred crores or more;
 - (B) holding, subsidiary, joint venture or associate companies

Appendix II: Extracts of Companies (Ind AS) Rules

of companies covered under item (A), other than those already covered under clauses (i), (ii) and (iii) of sub-rule (1) of rule 4.

- (b) The following NBFCs shall comply with the Indian Accounting Standards (Ind AS) for accounting periods beginning on or after the 1st April, 2019, with comparatives for the periods ending on 31st March, 2019, or thereafter-
 - (A) NBFCs whose equity or debt securities are listed or in the process of listing on any stock exchanges in India or outside India and having net worth less than rupees five hundred crore;
 - (B) NBFCs, that are unlisted companies, having net worth of rupees two-hundred and fifty crore or more but less than rupees five hundred crore; and
 - (C) holding, subsidiary, joint venture or associate companies of companies covered under item (A) or item (B) of sub-clause (b), other than those already covered in clauses (i), (ii) and (iii) of sub-rule (1) or item (B) of sub-clause (a) of clause (iv).

Explanation. – For the purposes of clause (iv), if in a group of Companies, some entities apply Accounting Standards specified in the Annexure to the Companies (Accounting Standards) Rules, 2006 and others apply accounting standards as specified in the Annexure to these rules, in such cases, for the purpose of individual financial statements, the entities should apply respective standards applicable to them. For preparation of consolidated financial statements, the following conditions are to be followed, namely:-

- (i) Where an NBFC is a parent (at ultimate level or at intermediate level), and prepares consolidated financial statements as per Accounting Standards specified in the Annexure to the Companies (Accounting Standards) Rules, 2006, and its subsidiaries, associates and joint ventures, if covered by clause (i), (ii) and (iii) of sub-rule (1) has to provide the relevant financial statement data in accordance with the accounting policies followed by the parent company for consolidation purposes (until the NBFC is covered under clause (iv) of sub-rule (1));

- (ii) where a parent is a company covered under clause (i), (ii) and (iii) of sub-rule (1) and has an NBFC subsidiary, associate or a joint venture, the parent has to prepare Ind AS- compliant consolidated financial statements and the NBFC subsidiary, associate or a joint venture has to provide the relevant financial statement data in accordance with the accounting policies followed by the parent company for consolidation purposes (until the NBFC is covered under clause (iv) of sub-rule (1)).
- (v) Notwithstanding clauses (i) to (iv), the holding, subsidiary, joint venture or associates companies of Scheduled commercial banks (excluding RRBs) would be required to prepare Ind AS based financial statements for accounting periods beginning from 1st April, 2018 onwards, with comparatives for the periods ending 31st March, 2018 or thereafter.

Provided that nothing in this sub-rule, except clause (i), shall apply to companies whose securities are listed or are in the process of being listed on SME exchange as referred to in Chapter XB or on the Institutional Trading Platform without initial public offering in accordance with the provisions of Chapter XC of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009.

Explanation 1. - SME Exchange shall have the same meaning as assigned to it in Chapter XB of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009.

Explanation 2. - "Comparatives" shall mean comparative figures for the preceding accounting period.

(2) For the purposes of calculation of net worth of companies under clause (i), (ii) and (iii) of 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

Appendix II: Extracts of Companies (Ind AS) Rules

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).

Illustration .- (i) The companies meeting threshold for the first time as on 31st March, 2017 shall apply Ind AS for the financial year 2017-18 onwards.

(ii) The companies meeting threshold for the first time as on 31st March, 2018 shall apply Ind AS for the financial year 2018-19 onwards and so on.

(2A) For the purposes of calculation of net worth of Non-Banking Financial Companies covered under clause (iv) of 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 NBFCs as on 31st March, 2016 or the first audited financial statements for accounting period which ends after that date;
- (b) for NBFCs which are not in existence on 31st March, 2016 or an existing NBFC falling first time, after 31st March, 2016, the net worth shall be calculated on the basis of the first audited stand-alone financial statements ending after that date, in respect of which it meets the thresholds.

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

Illustration – (i) The NBFCs meeting threshold for the time as on 31st March, 2019 shall apply Ind AS for the financial year 2019-20 onwards.

(ii) The NBFCs meeting threshold for the time as on 31st March, 2020 shall apply Ind AS for the financial year 2020-21 onwards and so on.

(3) Standards in Annexure to these rules once required to be complied with in accordance with these rules, shall apply to both stand-alone financial statements and consolidated financial statements.

(4) Companies to which Indian Accounting Standards (Ind AS) are applicable as specified in these rules shall prepare their first set of financial statements in accordance with the Indian Accounting Standards (Ind AS) effective at the end of its first Indian Accounting Standards (Ind AS) reporting period.

Explanation.- For the removal of doubts, it is hereby clarified that the companies preparing financial statements applying the Indian Accounting Standards (Ind AS) for the accounting period beginning on 1st April, 2016 or 1st April, 2018, as the case may be shall apply the Indian Accounting Standards (Ind AS) effective for the financial year ending on 31st March, 2017 or 31st March, 2019, as the case may be.

(5) Overseas subsidiary, associate, joint venture and other similar entities of an Indian company may prepare its standalone financial statements in accordance with the requirements of the specific jurisdiction:

Provided that such Indian company shall prepare its consolidated financial statements in accordance with the Indian Accounting Standards (Ind AS) if it meets the criteria as specified in sub-rule (1).

(6) 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).

(7) Any company opting to apply the Indian Accounting Standards (Ind AS) voluntarily as specified in sub-rule (1) for its financial statements shall prepare its financial statements as per the Indian Accounting Standards (Ind AS) consistently.

(8) Once the Indian Accounting Standards (Ind AS) are applied voluntarily, it shall be irrevocable and such companies shall not be required to prepare another set of financial statements in accordance with Accounting Standards specified in Annexure to Companies (Accounting Standards) Rules, 2006.

(9) Once a company starts following the Indian Accounting Standards (Ind AS) on the basis of criteria specified in sub-rule (1), it shall be required to follow the Indian Accounting Standards (Ind AS) for all the subsequent financial statements even if any of the criteria specified in this rule does not subsequently apply to it.

Appendix II: Extracts of Companies (Ind AS) Rules

5. The Banking Companies and Insurance Companies shall apply the Ind ASs as notified by the Reserve Bank of India (RBI) and Insurance Regulatory Development Authority (IRDA) respectively. An insurer or insurance company shall however, provide Ind AS compliant financial statement data for the purposes of preparation of consolidated financial statements by its parent or investor or venturer, as required by the parent or investor or venturer to comply with the requirements of these rules.

Note:

Insurers/ Insurance companies

- IRDAI vide press release dated June 28, 2017 has deferred the implementation of Ind AS for the Insurance Sector in India for a period of two years and the same shall now be implemented effective from 1st April 2020.

However, the requirement of submitting Proforma Ind AS financial statements on a quarterly basis shall continue to be governed as directed by IRDAI.

Scheduled Commercial banks (excluding Regional Rural Banks)

- RBI vide press release dated April 05, 2018 has deferred the implementation of Ind AS for the Scheduled Commercial Banks (excluding Regional Rural Banks) for a period of one year and the same shall now be implemented effective from 1st April 2019.

APPENDIX III

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Ind AS 2	-	Issue 65
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Appendix III: Indexation of Issues - Standard-wise

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Ind AS 101	Issue 25 to Issue 51	Issue 12, 57, 83, 88, 89, 90, 93, 94, 104, 107, 116 & 129
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APPENDIX IV

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