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IFRS Notes

Ind AS Transition Facilitation Group (ITFG) issues Clarifications Bulletin 10

12 July 2017

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Introduction

The ITFG in its meeting considered certain issues received from the members of the Institute of Chartered Accountants of India (ICAI), and issued its Bulletin 10 on 6 July 2017 to provide clarifications on six issues in relation to the application of Indian Accounting Standards (Ind AS).

Background

With Ind AS being applicable to corporates in a phased manner from 1 April 2016, the ICAI, on 11 January 2016 announced the formation of the Ind AS Transition Facilitation Group (ITFG) in order to provide clarifications on issues arising due to applicability and/or implementation of Ind AS under the Companies (Indian Accounting Standards) Rules, 2015 (Rules 2015).

Over the past year, ITFG issued nine bulletins to provide guidance on issues relating to the application of Ind AS. This issue of IFRS Notes provides an overview of the clarifications issued by ITFG through its Bulletin 10.

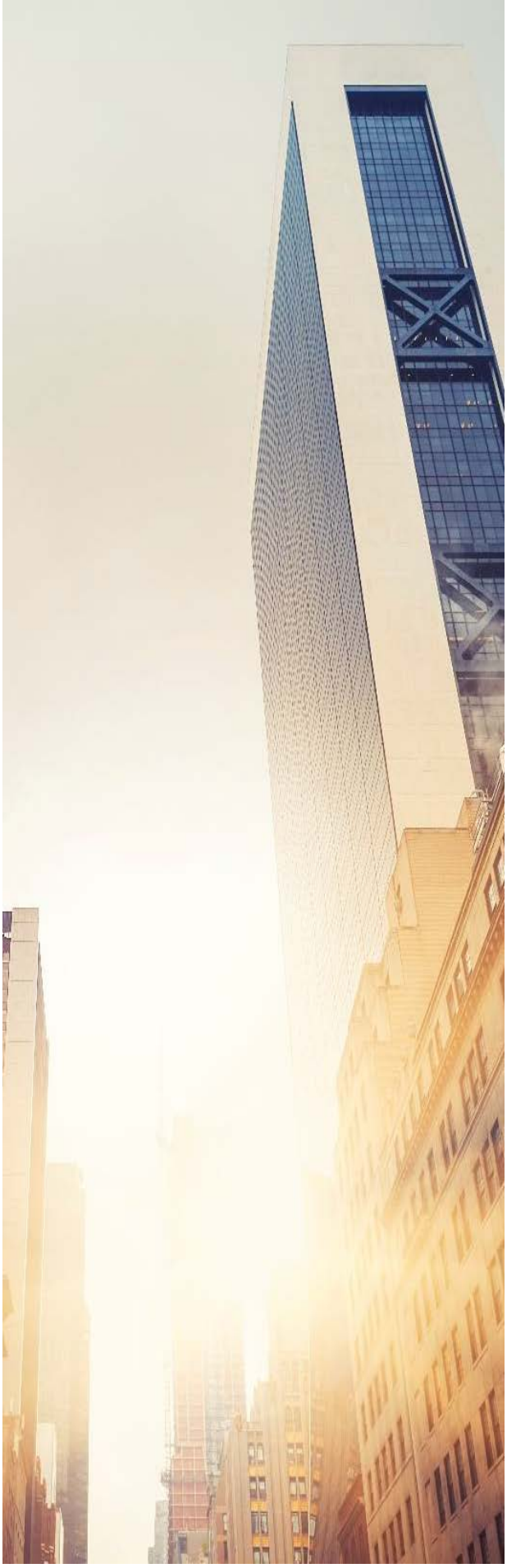
Overview of the clarifications in ITFG's Bulletin 10

The following issues relating to the application of Ind AS have been clarified in this bulletin.

1) **Accounting for interest-free loans provided by holding company in its stand-alone financial statements**

   Paragraphs D14 and D15 of Ind AS 101, *First-time Adoption of Indian Accounting Standards* permit an entity preparing separate financial statements to measure its investments in subsidiaries, joint ventures and associates either at cost, or in accordance with Ind AS 109, *Financial Instruments*. Where an entity has elected to measure such investments at cost, it may also elect to measure the investments in the Ind AS opening balance sheet at 'deemed cost', being either the fair value or the previous GAAP carrying amount of the investment on the date of transition to Ind AS.

   In accordance with this, ITFG considered a situation where a holding company (A Ltd.) had given an interest-free loan to its subsidiary (B Ltd.) before the date of transition to Ind AS. On transition to Ind AS, the subsidiary in its stand-alone financial statements accounted for the present value of the loan amount as a financial liability, and the difference between this amount and the carrying value of the loan as per previous GAAP was recognised as 'equity'. A Ltd. has elected to measure the investment in subsidiary at its previous GAAP carrying amount in accordance with paragraph D14 and D15 of Ind AS 101 on transition to Ind AS.



Overview of the clarification in ITFG's Bulletin 10 (contd…)

The issue considered by ITFG was the accounting treatment for the difference between the carrying value of the loan under previous GAAP and its present value in the stand-alone financial statements of A Ltd. under Ind AS.

The ITFG clarified that in accordance with paragraph 10 of Ind AS 101, on transition to Ind AS, an entity is required to recognise all assets and liabilities whose recognition is required by Ind AS. Although A Ltd. had exercised the option to measure its investment in its subsidiary at the previous GAAP carrying amount on the date of transition to Ind AS, the differential in the carrying value of the loan under previous GAAP and present value would be added to the investment in subsidiary measured at cost.

2) Accounting for processing fees paid relating to undisbursed term loans

The ITFG considered a situation where a company, covered in Phase I of the Ind AS implementation road map, had obtained a six year term loan from a bank in April 2010 and had paid the processing fees at the time of sanction of the loan. The term loan was disbursed in different tranches from April 2010 to April 2016. On the date of transition to Ind AS (1 April 2015), the company calculated the net present value of the term loan disbursed upto 31 March 2015, by using the Effective Interest Rate (EIR) and proportionately adjusted the processing fees in the EIR of the loan. The ITFG considered the accounting treatment of processing fees pertaining to the undisbursed term loan amount.

The ITFG clarified that the accounting treatment of processing fees relating to the undisbursed term loan would be dependent upon the probability of that portion of the loan being drawn down in the future. Where an entity has evidence that it is probable that the undisbursed portion of the loan would be drawn in the future, the processing fees would be accounted for as a transaction cost under Ind AS 109, and would be considered to be an integral part of the EIR of the term loan. The fees would be deducted from the carrying value of the loan when it is drawn, and the EIR of the loan would be adjusted to that effect. Accordingly, the fees would be amortised over the period of the loan. However, if it is not probable that the undisbursed portion of the loan would be drawn down in the future, the fees should be recognised as an expense on a straight-line basis over the term of the loan.

In the current case, ITFG assumed that the undisbursed portion of the loan would be drawn down in the future. Accordingly, ITFG opined that the entire amount of processing fees paid by the company would be included while computing the EIR of the loan on the date of transition to Ind AS.

3) Recognition of deferred tax asset on tax deductible goodwill of subsidiary, not recognised in the consolidated financial statements

The ITFG considered a situation where two subsidiaries (B Ltd. and C Ltd.) of a company (A Ltd.) were amalgamated, and as a result of this transaction, a goodwill was recognised in the separate financial statements of the amalgamated entity under previous GAAP. This goodwill is allowed as a deduction under Income-Tax laws in the books of the amalgamated entity. On transition to Ind AS, A Ltd. availed of the optional exemption under Ind AS 101 to not restate its past business combinations. Accordingly, on the date of transition to Ind AS, the goodwill was eliminated as a result of a consolidation adjustment in the consolidated financial statements of A Ltd. However, there was an increase in the tax base of the assets of the consolidated entity resulting from such tax deductible goodwill.

The issue under consideration was whether a deferred tax asset on the tax deductible goodwill should be recognised in the consolidated financial statements of A Ltd. under Ind AS when there is no corresponding accounting goodwill in these consolidated financial statements.

Ind AS 12, *Income Taxes* requires a deferred tax asset/liability to be created for all deductible/taxable temporary differences, except in specified situations, e.g., if it arises from the initial recognition of a business combination (initial recognition exemption). Ind AS 12 also states that a deferred tax asset may be created for assets or liabilities having a tax base but having nil carrying amount in the financial statements. The tax base should be determined by reference to the tax returns of each entity in the group. The deferred tax asset would be recognised to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised.

In this context, ITFG clarified that a deferred tax asset on the tax base of goodwill should be recognised in accordance with Ind AS 12 in the consolidated financial statements of A Ltd. It also stated that the initial recognition exemption would not apply since the amalgamation of the subsidiaries (i.e. business combination) did not result in the initial recognition of an asset or liability in the consolidated financial statements of A Ltd.

Overview of the clarification in ITFG's Bulletin 10 (contd…)

4) Applicability of deemed cost exemption on assets classified as held for sale

The ITFG considered a situation where a company (company X), prior to the date of transition to Ind AS, classified a group of assets as held for sale in accordance with AS 10, *Property, Plant and Equipment* and stated it at the lower of its net book value and net realisable value under previous GAAP. On transition to Ind AS, these assets did not fulfil the criteria for being classified as held for sale in accordance with Ind AS 105, *Non-current Assets Held for Sale and Discontinued Operations*, accordingly, these were classified as 'Property, Plant and Equipment' (PPE) under Ind AS.

The issue under consideration was whether company X can avail of the deemed cost exemption under paragraph D7AA of Ind AS 101, to continue with the previous GAAP carrying value of these assets as the deemed cost on transition to Ind AS.

The assets classified as held for sale in accordance with previous GAAP were presented separately from other fixed assets in the previous GAAP financial statements. However, they were not eliminated from the financial statements (as elimination would be warranted only on their disposal or when no future economic benefits were expected from their use or disposal).

The ITFG noted that paragraph D7AA of Ind AS 101 allowed entities to avail the deemed cost exemption for all PPE recognised in the financial statements at the date of transition to Ind AS, irrespective of whether these assets are disclosed separately. Accordingly, it clarified that in the current case, company X can avail the deemed cost exemption for 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 under Ind AS 105.

5) Consideration of amounts debited to FCMITDA for computation of basic earnings per share

The ITFG considered a situation where a company (MNC Ltd.) has availed of the option under paragraph D13AA of Ind AS 101 to continue applying the accounting treatment permitted by paragraph 46/46A of AS 11, *The Effects of Changes in Foreign Exchange Rates*. Accordingly, the company has continued to capitalise foreign exchange gains or losses on long-term foreign currency monetary items recognised prior to the first Ind AS financial reporting period. Such exchange gains/losses have been accumulated in a reserve (Foreign Currency Monetary Item Translation Difference Account (FCMITDA)).

The ITFG considered whether the amounts debited to FCMITDA would be required to be reduced from profit or loss from continuing operations for the purpose of calculating basic earnings per share (EPS) in accordance with Ind AS 33, *Earnings per Share*.

Ind AS 33 refers to items of income and expense which are required by Ind AS to be recognised in the statement of profit and loss, but have been debited or credited to securities premium/other reserves. It requires such items of income and expense to be added to/deducted from profit or loss from continuing operations for computing the basic EPS.

In this context, ITFG clarified that accumulation of exchange differences arising from translation of long-term foreign currency monetary items in FCMITDA is permitted under the optional exemption available in Ind AS 101. Therefore, this accounting treatment is in accordance with Ind AS and such exchange differences are not required to be reduced from profit or loss from continuing operations for the purpose of computing basic EPS.

6) Classification of expenses for providing free third party goods

The ITFG considered a situation where a company (company X) participated in a customer loyalty programme operated by a third party. The members of the programme earned points for purchases made in company X's stores and could redeem the points for goods supplied by the third party. Company X fulfils its obligation to programme members once they have been granted points on making purchases in its stores, and the obligation to supply the redeemed goods lies with the third party. As on 31 March 2017, the estimated fair value of the total award points granted by X amounted to INR20,000 and it owed the third party INR17,000. The ITFG considered the accounting treatment and classification of expenses incurred for providing free third party goods to its customers (i.e. INR17,000 in this case).

The ITFG clarified that to determine the accounting treatment and the classification of the amounts, Appendix B, Customer Loyalty Programmes of Ind AS 18, Revenue, requires Company X to assess whether it is acting as an agent of the third party or as the principal in the transaction.

Overview of the clarification in ITFG's Bulletin 10 (contd…)

- **If company X is acting as an agent:** The difference between the consideration allocated to the award credits and the amount payable to the third party for supplying awards (in this case INR3,000) should be recognised as commission income. This amount will be recognised as revenue when the third party becomes obliged to supply the awards and entitled to receive consideration for doing so.
- **If company X is acting as a principal:** It shall measure its revenue as the gross consideration allocated to the award credits (i.e. INR20,000) and recognise the revenue when it fulfils its obligations in respect of the awards. The costs incurred for providing free third party goods (i.e. INR17,000) will be charged to the statement of profit and loss as the costs of goods sold.

Our comments

The ITFG clarifications are expected to resolve various practical implementation issues faced by several companies that have transitioned or are transitioning to Ind AS. Such companies should consider the interpretations provided by ITFG in their implementation efforts. However, it should be noted that some of the issues require the application of judgement based on a consideration of facts and circumstances while analysing each individual situation.

Specifically, companies may consider the following aspects:

a) This is the first clarifications' bulletin issued by ITFG after listed entities that have transitioned to Ind AS in Phase 1 have published their annual financial results for the financial year (FY) 2016-17. Accordingly, these companies may be required to evaluate the impact of such clarifications going forward, as well as on their Ind AS financial statements for FY 2016-17. For instance, parent entities that have transitioned to Ind AS during the financial year 2016-17 and elected to measure their investments in subsidiaries at deemed cost (based on previous GAAP carrying amounts) may have adjusted the difference between the carrying amount and present value of an interest-free loan provided to a subsidiary, in retained earnings. This was on the basis that Ind AS 101 did not permit further adjustments to the deemed cost of an investment. These companies would be required to carefully evaluate the impact arising from the clarification provided by ITFG in Bulletin 10, requiring the difference between the present value and carrying amount of such loans to be adjusted in the cost of investment.

b) The ITFG has opined that loan processing fees incurred on the undisbursed component of a loan should be recognised as an expense on a straight-line basis over the term of the loan if it is not probable that this component will be drawn down in the future. If an entity has paid fees that are in the nature of facility or commitment fees for ensuring availability of funds during the draw-down period of a loan, we consider that it may be appropriate to recognise such fees incurred on the undrawn component as an expense over the facility commitment period. In that scenario, the fees would relate to arranging the loan facility and are intended to compensate the bank for keeping funds available during the commitment period. This commitment period could be shorter than the term of the loan (relating to a component that may have been drawn down).

c) The clarification provided by ITFG on the classification of expenses for providing free third party goods would also apply to similar arrangements where customers are entitled to receive free third party products or services based on the volume of purchases made from the reporting entity. Companies that offer such schemes or rewards should consider the impact of this clarification when determining the appropriate accounting treatment.

KPMG in India

Ahmedabad
Commerce House V, 9th Floor
902 & 903, Near Vodafone House
Corporate Road, Prahaladnagar
Ahmedabad 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru
Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala, Bengaluru 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh
SCO 22-23 (Ist Floor)
Sector 8C, Madhya Marg
Chandigarh 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai
No.10, Mahatma Gandhi Road
Nungambakkam
Chennai 600 034
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Gurgaon
Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurgaon, Haryana 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad
8-2-618/2
Reliance Humsafar, 4th Floor
Road No.11, Banjara Hills
Hyderabad 500 034
Tel: +91 40 3046 5000
Fax: +91 40 3046 5299

Kochi
Syama Business Center
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata
Unit No. 603 – 604, 6th Floor,
Tower - 1, Godrej Waterside,
Sector – V,
Salt Lake, Kolkata - 700 091
Tel: +91 33 44034000
Fax: +91 33 44034199

Mumbai
Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida
6th Floor, Tower A
Advant Navis Business Park
Plot No. 07, Sector 142
Noida Express Way
Noida 201 305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune
703, Godrej Castlemaine
Bund Garden
Pune 411 001
Tel: +91 20 3058 5764/65
Fax: +91 20 3058 5775

Vadodara
iPlex India Private Limited,
1st floor office space, No. 1004,
Vadodara Hyper, Dr. V S Marg
Bund Garden
Vadodara 390 007
Tel: +91 0265 235 1085/232 2607/
232 2672

You can reach out to us for feedback and questions at:
in-fmkpmgifrsinst@kpmg.com

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Voices on Reporting

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

In our recent call on Wednesday, 5 April 2017, we covered key financial reporting and regulatory matters that are expected to be relevant for stakeholders pertaining to the quarter ended 31 March 2017.

Our call included updates from the Ministry of Corporate Affairs (MCA), the Securities and Exchange Board of India (SEBI), the Reserve Bank of India (RBI), etc.

In our VOR quarterly updates, we have summarised key updates relating to the quarter ended 30 June 2017 from the MCA, the SEBI, the RBI, the Institute of Chartered Accountants of India (ICAI), the Insurance Regulatory and Development Authority of India (IRDA) and the Central Board of Direct Taxes (CBDT).

Missed an issue of our Accounting and Auditing Update or First Notes

Issue no. 11/2017 – June 2017

Continuing with our series of articles on the revised requirements of the Companies Act, 2013 (2013 Act), this month's edition of the Accounting and Auditing Update (AAU) carries an article describing key responsibilities of directors, and also compares the requirements of the 2013 Act with the Securities and Exchange Board of India's (SEBI) regulations with regard to directors.

In the second article of the series covering Ind AS implementation issues for entities in the financial services sector, we explain the concept of a business model assessment to be undertaken by banks on transition to Ind AS for loans advanced and investments made.

This edition carries an article explaining the deemed cost exemption for property, plant and equipment and also highlights the challenges/implications in accounting for the same on Ind AS transition. This article also covers the implication on Minimum Alternate Tax (MAT) computation both on transition and in subsequent annual financial statements.

Our article on accounting for lease of land under Ind AS emphasises the need to assess all of the lease classification indicators before classifying a lease as an operating or a finance lease.

The publication also carries regular round up of regulatory updates in India and internationally.

MCA issues further relaxations from certain provisions of the Companies Act, 2013

23 June 2017

The Ministry of Corporate Affairs (MCA) through its notifications dated 5 June 2015, provided certain exceptions/ modifications/ adaptations to some of the provisions of the Companies Act, 2013 (2013 Act) for the following class of companies:

- Private companies
- Companies formed with the charitable objects, etc. (Section 8 companies)
- Government companies.

The MCA through its notifications dated 13 June 2017 and 22 June 2017, provided further exceptions/modifications/adaptations to the provisions of the 2013 Act for the above mentioned class of companies.

These exceptions/ modifications/ adaptations would be available to the companies which have not defaulted in filing of its financial statements under Section 137 or annual return under Section 92 of the 2013 Act with the Registrar of Companies.

This issue of First Notes provides an overview of the exceptions/ modifications/ adaptations made to the 2013 Act for private companies, Section 8 companies and government companies.

Previous editions are available to download from: www.kpmg.com/in