



Accounting and Auditing Update

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Editorial





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Ind AS has introduced new accounting concepts into financial reporting in India. 'Non-current assets held for sale' is one such concept. Previous Indian GAAP did not contain a specific standard on this topic. Therefore, in this month's Accounting and Auditing Update (AAU), we elaborate on the concept of held for sale and explain classification, measurement and presentation requirements of assets so categorised.

As financial institutions prepare to transition to Ind AS, they need to apply the Expected Credit Loss (ECL) model to measure impairment on their financial assets subsequently measured at amortised cost, or debt instruments at fair value through other comprehensive income. ECL is computed on a probability-weighted basis. However, Ind AS 109, *Financial Instruments*, does not prescribe methods or techniques for computing ECL. Therefore, this is an area of significant complexity for financial institutions as they transition to Ind AS. Our series of articles will introduce and explain various concepts surrounding the computation of ECL. In this edition of AAU, our article provides an overview of the 'staging assessment' required to be performed by financial institutions to determine the extent of expected losses to be recognised under Ind AS.

In our Companies Act, 2013 article, we provide an overview of the provisions relating to loans and investments made by companies. The article also highlights the requirements of the Securities and Exchange Board of India's regulations with regard to loans and investments made by the companies.

In a business combination, an acquirer may be obliged to replace share-based payment awards granted to the employees of the acquiree. In certain cases, an acquirer may voluntarily replace such awards, whereas in other cases the awards may not be replaced. Ind AS provides guidance on the accounting of such replaced and unreplaced awards and highlights the situations when the market-based measure of the replaced share-based payment awards would be accounted as a business combination cost. Our article on this topic describes the accounting treatment in these three scenarios along with an illustration.

As is the case with each month, we also cover a regular round-up of some recent regulatory updates in India.

We would be delighted to receive feedback/suggestions from you on the topics we should cover in the forthcoming editions of AAU.



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Non-current assets held for sale - concept



This article aims to:

- Highlight the classification, measurement and presentation requirements of non-current assets classified as held for sale.

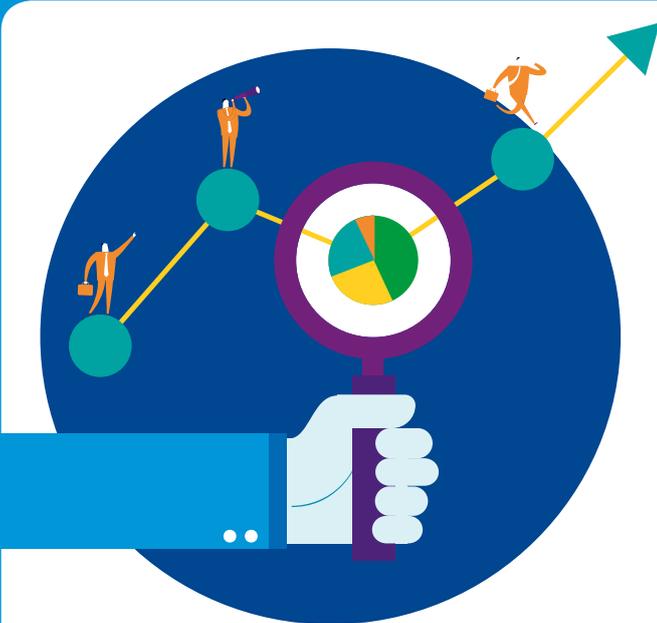
Under Indian Accounting Standard (Ind AS), Ind AS 105, *Non-current Assets Held for Sale and Discontinued Operations* is a separate standard that deals with the guidance on classification, measurement and presentation of non-current assets held for sale.

Under Indian Generally Accepted Accounting Principles (GAAP), erstwhile AS 10, *Accounting for Fixed Assets*, provided limited guidance on accounting of fixed assets that have been retired from active use and are held for disposal. The revised AS 10, *Property, Plant and Equipment* also provides similar guidance as the erstwhile AS.

This article aims to highlight the guidance regarding classification, measurement and presentation of non-current assets held for sale.

Non-current assets and disposal groups - definition

Under Ind AS, assets are classified as non-current in accordance with Ind AS 1, *Presentation of Financial Statements*. The classification and presentation requirements of this Ind AS 105 apply to all recognised non-current assets and to all *disposal groups* of an entity. Examples of non-current assets are property, plant and equipment, intangible assets, financial assets, investment property, etc.



Disposal groups - definition

A disposal group is a group of assets that would be disposed of, by sale or otherwise, together as a group in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction.

The group could include goodwill acquired in a business combination if the group is a **cash-generating unit** to which goodwill has been allocated

in accordance with the requirements of Ind AS 36, *Impairment of Assets*, or if it is an operation within such a cash-generating unit.

Examples of disposal groups are investments in a subsidiary, associate or joint venture, a division, etc.

Held for sale – definition

A non-current asset or disposal group (a group of assets to be disposed of together) is classified

as held-for-sale when the following criteria are met:

- Dispose of together in a single transaction
- Its carrying amount will be recovered principally through a sale transaction:
 - Available for immediate sale in current condition
 - Sale is highly probable.

The following table discusses each of the above criteria in detail:

Condition	Description
Sale transaction	An asset or a disposal group would be classified as held for sale only when it would be recovered principally through a sale transaction. Therefore, non-current assets that are to be abandoned or mothballed would not be classified as held for sale.
Current condition	An asset should be available for immediate sale in its present condition. Immediate sale does not rule out terms that are usual and customary for sale. However, a company that plans to sell its building where its headquarters are located may first need to obtain or construct a replacement asset (e.g. a new headquarters). This means that the asset is not available for immediate sale.
Highly probable and within one year	For a sale to be considered as highly probable, the following conditions must be satisfied: <ul style="list-style-type: none"> • The appropriate level of management must be committed to a plan to sell the asset • Active programme to locate a buyer and complete the plan must have been initiated • Asset must be actively marketed at a price that is reasonable in relation to its current fair value • Sale should be expected to qualify for recognition as a complete sale within one year from the date of classification, unless the delay is caused by events or circumstances beyond the entity's control and there is sufficient evidence that the entity remains committed to its plan to sell the asset • Actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.
Approvals – shareholders or regulators	For some entities, the sale of significant non-current assets or disposal groups may be subject to shareholders' approval. Shareholders' approval is considered as part of whether the sale is highly probable. Therefore, the requirement to obtain shareholders' approval does not necessarily mean that the criteria for classification as held for sale are met only when shareholders' approval is obtained. However, if substantive shareholders' approval for a sale is required, then the sale might not be highly probable until shareholders' approval is obtained. The sale of significant non-current assets or disposal groups may also be subject to regulatory approval. Depending on particular circumstances, regulatory approval may be considered substantive or, on the contrary, viewed as a formality. If after considering all available evidence, the management concludes that the pending regulatory approval does not prevent the sale from being highly probable, then it may not necessarily prevent the classification of the non-current assets or disposal groups as held for sale.

If all of the above criteria are not met, then an entity would not qualify as an asset or a disposal group as held for sale.

Challenges

Certain challenges that entities may face while classifying their assets as held for sale are as follows:

Sale takes more than one year

Certain events or circumstances may extend the period to complete the sale beyond one year. Therefore, an entity may require an extension of the period to complete. An extension period does not preclude an asset (or disposal group) from being classified as held for sale if the delay is caused by events or circumstances beyond the entity's control, and there is sufficient evidence that the entity remains committed to its plan to sell the asset (or disposal group).

Ind AS 105 allows an exception to the one-year requirement only in the following situations:

- a. The date on which an entity commits itself to a plan to sell a non-current asset (or disposal group), it reasonably expects that others (not a buyer) will impose conditions on the transfer of the asset (or disposal group) that will extend the period required to complete the sale, and:
 - i. actions necessary to respond to those conditions cannot be initiated until after a firm purchase commitment is obtained, and
 - ii. a firm purchase commitment is highly probable within one year.
- b. An entity obtains a firm purchase commitment and, as a result, a buyer or others unexpectedly impose conditions on the transfer of a non-current asset (or disposal group) previously classified as held for sale that will extend the period required to complete the sale, and:
 - i. timely actions necessary to respond to the conditions that have been taken, and
 - ii. a favourable resolution of the delaying factors is expected.

- c. During the initial one-year period, circumstances arise that were previously considered unlikely and, as a result, a non-current asset (or disposal group) previously classified as held for sale is not sold by the end of that period, and:
 - i. during the initial one-year period the entity took action necessary to respond to the change in circumstances,
 - ii. the non-current asset (or disposal group) is being actively marketed at a price that is reasonable, given the change in circumstances, and
 - iii. the criteria for held for sale are met.

Non-current assets acquired to be sold

An entity may acquire a non-current asset (or disposal group) exclusively with a view to its subsequent disposal. In order to classify such an asset (disposal group) as held for sale, it should satisfy:

- at the acquisition date, one-year requirement (except when it is covered in the exception as explained above)
- within three months it is highly probable the rest of the criteria for held for sale are met.

Criteria met after the reporting period

If the criteria for held for sale are met after the reporting period, an entity would not classify a non-current asset (or disposal group) as held for sale in those financial statements when issued. However, when those criteria are met after the reporting period but before the approval of the financial statements due for release, the entity should disclose following information in the notes:

- A description of the non-current asset (or disposal group)
- A description of the facts and circumstances of the sale, or

leading to the expected disposal, and the expected manner and timing of that disposal

- If applicable, the reportable segment in which the non-current asset (or disposal group) is presented in accordance with Ind AS 108, *Operating Segments*.

Sale of a subsidiary when non-controlling interest is retained

An entity that is committed to a sale plan involving loss of control of a subsidiary shall classify all the assets and liabilities of that subsidiary as held for sale when the criteria are met, regardless of whether the entity will retain a non-controlling interest in its former subsidiary after the sale.

Measurement of non-current assets classified as held for sale

Non-current assets held for sale are measured at lower of their carrying amounts or fair value less cost to sell.

Before classification as held for sale, non-current assets and the assets and liabilities in a disposal group are measured in accordance with applicable Ind AS. For example, property, plant and equipment is tested for impairment. Therefore, any resulting gains or losses should be recognised in accordance with the relevant standards.

However, the measurement provisions of this Ind AS do not apply to the following assets, which are covered by the Ind ASs listed, either as individual assets or as part of a disposal group:

- a. Deferred tax assets (Ind AS 12, *Income Taxes*)
- b. Assets arising from employee benefits (Ind AS 19, *Employee Benefits*)
- c. Financial assets within the scope of Ind AS 109, *Financial Instruments*

- d. Non-current assets that are measured at fair value less costs to sell in accordance with Ind AS 41, *Agriculture*
- e. Contractual rights under insurance contracts as defined in Ind AS 104, *Insurance Contracts*.

These assets are excluded either because measurement would be difficult (e.g. deferred tax assets) or because the assets are generally carried on the basis of fair value with changes in fair value recognised in profit or loss (e.g. investment property measured at fair value).

Excluded assets are measured using the standards that normally apply to these items, even if such assets are part of a disposal group. However, the disposal group as a whole is measured in a manner consistent

with non-current assets that are held for sale.

As a result, non-current assets such as some financial assets may be classified and presented as held for sale but measured in accordance with other standards.

In the case of a disposal group, although the group as a whole is measured at the lower of carrying amount and fair value less costs to sell, some of the individual assets and liabilities within that disposal group may be those assets to which the measurements requirements of Ind AS 105 do not apply.

Presentation

Non-current assets held for sale and assets of a disposal group classified as held for sale are presented

separately from other assets in the balance sheet. The liabilities of a disposal group classified as held for sale are presented separately from other liabilities in the balance sheet.

If the disposal group is a newly acquired subsidiary that meets the criteria to be classified as held for sale on acquisition, disclosure of the major classes of assets and liabilities is not required. An entity should not reclassify or re-present amounts presented for non-current assets or for the assets and liabilities of disposal groups classified as held for sale in the balance sheets for prior periods to reflect the classification in the balance sheet for the latest period presented.

Consider this....

- Non-current assets and some groups of assets and liabilities (known as disposal groups) are classified as held for sale when their carrying amounts will be recovered principally through sale.
- Assets classified as held for sale are not amortised or depreciated.
- Non-current assets and disposal groups held for sale are generally measured at the lower of their carrying amount and fair value less cost to sell, and are presented separately on the face of the balance sheet.
- The comparative balance sheet is not re-presented when a non-current asset or disposal group is classified as held for sale.



Expected credit loss - analysis of significant increase in credit risk



This article aims to:

- Provide an overview of the ‘staging assessment’ required to be performed by financial institutions to determine the extent of expected losses to be recognised under Ind AS.



Banks in India currently follow a standardised approach to measuring impairment in the value of their loan assets in accordance with the Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances (Prudential Norms) issued by the Reserve Bank of India (RBI). The Prudential Norms require categorisation of advances as standard assets, sub-standard assets, doubtful assets and loss assets and prescribe the minimum percentage of impairment allowance to be recognised by banks on such assets.

Indian Accounting Standard (Ind AS) 109, *Financial Instruments* modifies the approach for measuring impairment from being driven by regulation to one based on the entity’s assessment of expected losses. Ind AS 109 requires all financial assets which are subsequently measured at amortised cost or debt instruments at Fair Value through Other Comprehensive Income (FVOCI) to be assessed for impairment, and a loss allowance to be recognised using the Expect Credit Loss (ECL) model.

Expected credit losses are computed on a probability-weighted basis, as the present value of the difference between cash flows that are due to the entity in accordance with the contractual terms of a financial instrument and the cash flows that the bank expects to receive. Although Ind AS 109 specifies this objective, it does not prescribe methods or techniques for computing ECL. Measurement of ECL is, therefore, an area of significant complexity for banks as they transition to Ind AS.

Internationally, the International Accounting Standards Board (IASB) established the Impairment Transition Group (ITG) to provide more clarity on issues relating to assessing impairment and measuring ECL under International Financial Reporting Standard (IFRS) 9, *Financial Instruments*. This guidance would be equally relevant for banks in India in their implementation of Ind AS 109.

This is the first in a series of articles on ECL that introduce and explain various concepts surrounding the computation of ECL. In this article, we provide an overview of the ‘staging assessment’ required to be performed by financial institutions to determine the extent of expected losses to be recognised under Ind AS 109.

Key characteristics of loans

The corporate banking division of Bank E (the bank), provides credit facilities against collateral to companies operating in different sectors. The bank monitors its exposure to credit risk and the subsequent performance of these facilities by segmenting them based on the type of loans advanced and the sectors within which the borrowers operate.

The bank has developed an internal credit risk rating system, wherein each borrower is assigned a risk

grade ranging from 1 to 10, with 1 denoting the lowest credit risk and 10 the highest. The internal rating system is developed by calibrating the risk grades based on certain credit characteristics and the probability of default associated with each grade. The effectiveness of the internal credit risk rating system is periodically reviewed, calibrated and validated to ensure that the risk grades reflect the credit risk appropriately.

Risk grades are assigned to borrowers based on all available information including timeliness

of interest payment/principal repayment, the company's financial performance, the industry outlook and other macroeconomic forward-looking factors. The assessed risk of default increases on a non-linear basis from one grade to the next. The risk management team of the bank considers all companies with an internal credit risk rating of 1 and 2 to have a 'low risk of default'. The risk management team validates the effectiveness of the internal credit risk rating on a quarterly basis.

The bank has advanced the following term loans to companies operating in the iron and steel sector.

Sr. No.	Name of company	Amount and terms of loan	Internal credit rating on origination
1	U Ltd.	Loan amount: INR1,000 million Loan extended in FY2008-09, for establishing a new plant, is repayable in 20 equal annual instalments with effect from 31 December 2008. Interest is payable at 12.5 per cent per annum.	U Ltd. was a well-established and profitable investment grade company operating for the last 20 years. Bank E, accordingly assessed its credit risk as 'low' and assigned an internal credit rating of 1 on origination.
2	C Ltd.	Loan amount: INR500 million Loan extended in FY2011-12 for expanding the plant, is repayable in 10 equal annual instalments with effect from 31 March 2012. Interest is payable at 13.75 per cent per annum.	C Ltd. was an investment grade company, operating for over 50 years, producing high-quality steel and had demonstrated a trend of reliable growth. Considering this, and its loan repayment history, the bank assessed its credit risk as 'low' and assigned an internal credit rating of 2 on origination.
3	M Ltd.	Loan amount: INR700 million Loan extended in FY2013-14 for purchase of new machinery and is repayable in 15 equal annual instalments with effect from 31 March 2014. Interest is payable at 15.5 per cent per annum.	M Ltd. was established 8 years ago. Although it had a good credit standing, it had a relatively short credit history. The bank considered the corporate to be susceptible to changing economic conditions and accordingly, assigned it an internal credit rating of 4 on origination.
	A Ltd.	Loan amount: INR250 million Loan extended in FY2014-15 towards project expenditure on its new plant, is repayable in 10 equal annual instalments with effect from 30 September 2015. Interest is payable at 17.5 per cent per annum.	A Ltd. has been vulnerable to changing economic conditions. In the past, it has delayed repayment of certain loans as a result of declining performance and a worsening economic scenario. Considering these factors, the bank assigned an internal credit rating of 6 on origination.

The risk rating has been linked to the 12 month Probability of Default (PD) as below:

Rating	Risk	12 month Probability of Default (PD)
1 – 2	Low risk	0.5% to 2%
3 – 6	Medium risk	2.1% to 10%
7 – 9	High risk	10.1% to 17.5%
10	Credit impaired	It is expected that the borrower would default on repayment of the loan

The bank considers that a change in the risk rating by two credit grades or more (e.g. change in rating from 2 to 4) generally represents a significant increase in credit risk.

As per the policy of the bank, loans provided to companies operating in infrastructure and government related sectors (including iron and steel) are held to collect. The

interest and principal repayments on these loans are solely payments of principal and interest on the principal amount outstanding. Therefore, the term loans described above are classified and subsequently measured at amortised cost under Ind AS 109.

Based on an analysis at the current reporting date, i.e. 31 March 2017,

the bank assessed that in the past three to four years, a decline in global steel prices has resulted in a deterioration in the financial health of companies operating in the steel sector. Considering this, the bank re-evaluated the internal credit risk rating for the term loans as on 31 March 2017. The risk rating at the reporting date for the outstanding term loans is as follows:

Sr.No	Name of company	Outstanding loan amount in INR	Internal credit risk rating as on 31 March 2017	Remarks
1	U Ltd.	550 million	2	Despite stressed conditions, U Ltd. has demonstrated a strong capacity to repay its debts. However, there has been a decline in the profitability of the company over the previous financial year.
2	C Ltd.	250 million	3	In FY2016-17, C Ltd. reported a net loss although it still earned an operating profit. During the financial year, C Ltd. had to settle a certain one-off obligation, which resulted in a temporary cash shortfall. This led to a delay in the repayment of a loan instalment and the interest due during the year. However, the company repaid these overdue amounts in March 2017, prior to the reporting date.
3	M Ltd.	513.3 million	7	The current economic conditions have led to significant financial difficulties for M Ltd. There have been significant delays (over 60 days) in interest and principal repayments and M Ltd has reported operating losses in FY2016-17.
4	A Ltd.	200 million	10	A Ltd. is under severe stress due to delayed implementation of its project as a result of delays in obtaining various legal and environmental clearances. Its cash flows from its existing plant are not sufficient to repay the loan instalments and it has defaulted in payment of its contractual cash flows (the principal and interest due on the loan). It is currently in the process of entering into a negotiation to restructure the loan.

As per the Prudential Norms, loans advanced to M Ltd. and A Ltd. are 'non-performing assets', a provision for this has been accordingly recorded in the books of accounts.

Accounting issue

Ind AS 109 requires banks to recognise a loss allowance at an amount equal to 12-month expected credit losses (i.e. expected credit losses that result from defaults that are possible within 12 months after the reporting date) for financial assets where the credit risk has not increased significantly since initial

recognition. However, for financial assets where the credit risk has increased significantly since initial recognition, the loss allowance should be measured at an amount equal to lifetime expected credit losses (i.e. losses that result from all possible defaults over the expected life of a financial asset).

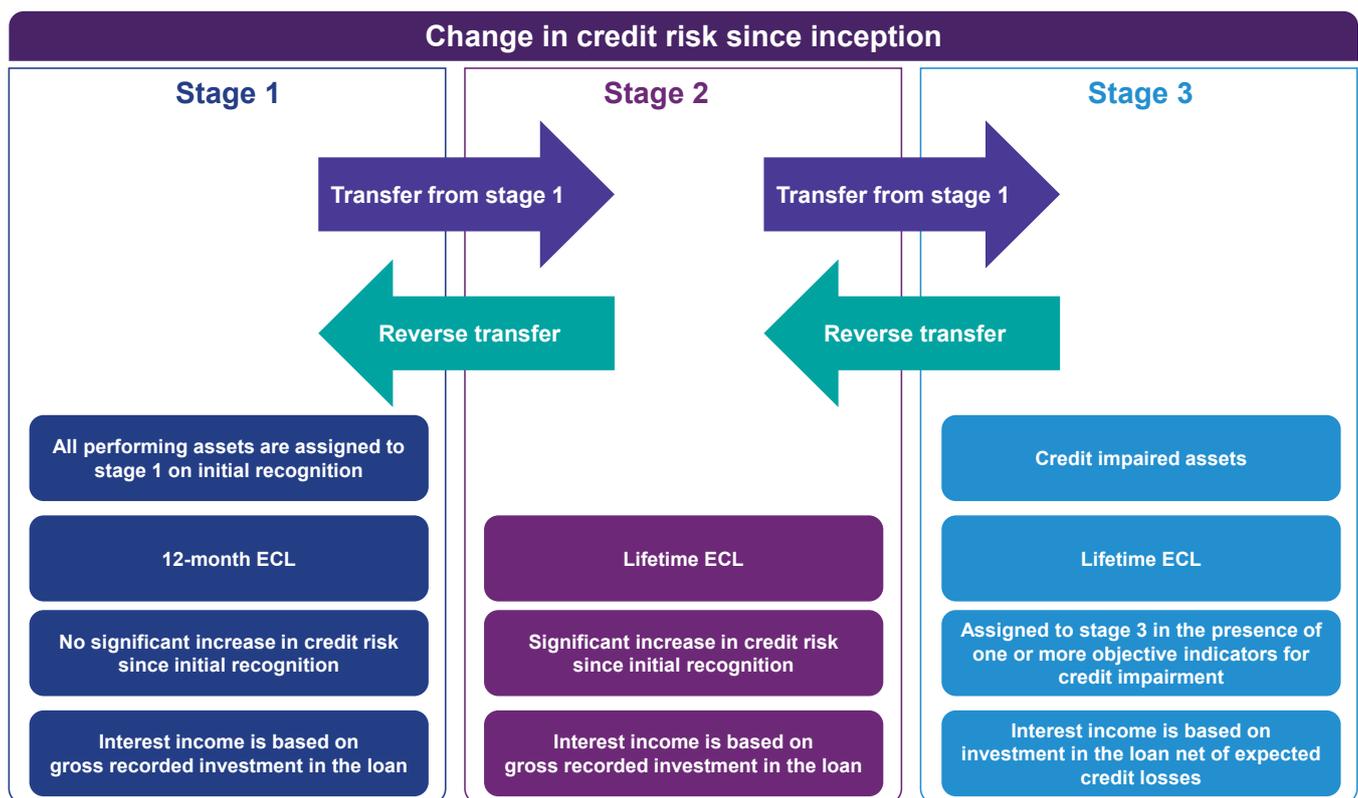
A bank would be required to perform a 'stage transfer' analysis for its financial assets to determine whether credit risk has increased significantly since initial recognition and identify those assets for which the loss allowance should be

measured on the basis of lifetime expected losses.

In the current case study, bank E is required to perform this analysis for its loans to determine whether there has been a significant increase in their credit risk since initial recognition. This would in turn determine whether a 12-month ECL or a lifetime ECL should be considered while computing the loss allowance on these financial assets. Figure 1 below illustrates this 'stage transfer' analysis.

Accounting guidance

Figure 1: Stage transfer analysis for expected credit losses



(Source: KPMG in India's analysis read with KPMG IFRG's Insights into IFRS, 13th edition 2016/17)

Analysis

Stage transfer analysis

A stage allocation and stage transfer analysis is critical for all banks, since the stage to which a financial asset is allocated on the date of evaluation, would determine the extent of loss allowance recognised on that asset. Under the general impairment approach in Ind AS 109, all financial instruments are allocated to stage 1 on initial recognition. If an asset's credit risk has not increased significantly since initial recognition (i.e. it remains in stage 1), then the bank would be required to recognise 12-month ECL as a loss allowance for the asset. On the other hand, if the credit risk of the financial asset has significantly increased/it is credit impaired (i.e. it is transferred to stage 2 or stage 3), then a loss allowance equal to lifetime ECL should be recognised.

Reference parameter for measuring risk of default

In order to determine whether there has been a significant increase in credit risk, the bank

is required to compare the risk of default estimated at the time of initial recognition of the financial asset (for its remaining maturity at the reporting date) with the risk of default at the reporting date. The risk of default should be generally measured with reference to changes in the lifetime PD for the asset. Therefore, a significant increase in credit risk would be determined by comparing the lifetime PD at the reporting date with the portion of lifetime PD estimated on initial recognition that corresponds with the remaining maturity of the financial asset at the reporting date (i.e. the forward lifetime PD).

In the absence of information necessary to determine the forward PD, a bank may compare the 12-month PD as determined at the inception of the loan to that as at the reporting date if the 12-month PD is a reasonable approximation of the change in lifetime risk of default. In this case study, the internal credit rating system is calibrated based on the 12-month PD associated with those credit exposures. Further, the internal credit rating system is tested

and validated on a regular basis to ensure that it remains updated and reliable. On this basis the bank's policy is that a downgrade of two or more grades in the credit rating generally represents a significant increase in credit risk.

The bank may also consider adopting other quantitative, qualitative and other 'backstop' indicators for assessing changes in credit risk. For example, qualitative factors pertaining to the company's performance, the industry outlook and the current macroeconomic conditions may be considered by the bank while assessing an increase in credit risk. The value of collateral, however, should not be considered while determining the PD of the loan to assess if there has been a significant increase in credit risk.

Analysis of loans

The bank determines whether there has been a significant increase in credit risk by comparing the internal credit risk rating of the loans at the date of origination with that on the reporting date. This comparison is given below:

Name of the company	U Ltd.	C Ltd.	M Ltd.	A Ltd.
Expected internal credit risk rating on reporting date	1	2	4	6
Internal credit risk rating on reporting date	2	3	7	10

(Source: KPMG in India's analysis, 2017)

On initial recognition, all loans (other than loans that are credit impaired), irrespective of their PD/internal credit risk rating, are categorised as stage 1. Subsequently, while performing a staging analysis on the reporting date, a combination of qualitative and quantitative factors, including forward-looking information are considered to determine whether there has been a significant increase in credit risk.

U Ltd.

U Ltd. is a well established and profitable company. Its investment grade (blue-chip company) reflects

that it has a strong capacity to meet its contractual cash flow obligations, and is not expected to be significantly affected by unfavourable changes in economic and business conditions. On initial recognition, bank E has assessed this loan to have a low risk of default.

Ind AS 109 permits banks to assume that the credit risk on a financial asset has not increased significantly if those financial assets have a low credit risk on the reporting date. Such borrowers are generally financially stable and adverse changes in economic conditions would not necessarily

reduce their ability to fulfil their contractual cash flow obligations. A staging assessment for these assets is generally not performed (unless there are indicators of a significant increase in credit risk), as it may be assumed that a credit risk on such assets has not increased significantly since initial recognition. For example, assets above a certain credit rating or those considered as 'investment grade' may be considered to have a 'low risk of default'. Banks should exercise caution in assessing the credit risk of financial assets before making this assumption.

A reduction in profits of U Ltd. as compared to the previous financial year is in line with the industry performance, which indicates a deterioration in the financial health of Indian steel companies as a result of various global and domestic factors. In spite of the sectoral stress and the reduced profits, U Ltd. has demonstrated a strong capacity to repay its debts, hence the loan advanced to U Ltd. continues to remain low credit risk in nature. This loan would, therefore, not be considered for the staging assessment.

C Ltd.

C Ltd. is an investment grade company with a history of manufacturing high-quality products and has consistently demonstrated reliable growth. As a result, on original recognition, bank E considers the loan to C Ltd as low risk.

Due to adverse economic conditions and the requirement to meet certain one off obligations, C Ltd. experienced a temporary cash shortfall and delayed the repayment of one loan instalment by 30 days during the year. As per Ind AS 109, this is a backstop indicator which is generally considered to reflect an increase in credit risk. These factors have resulted in a decline in the

internal credit rating of the loan (i.e. the loan is no longer 'low risk' at the reporting date).

As per Ind AS 109, if a financial asset is no longer considered 'low risk' at the reporting date, the bank cannot assume that there has been no significant increase in credit risk associated with that asset. Therefore, the loan to C Ltd. is analysed as part of the staging assessment. In this case, the company had delayed the payment of an instalment by 30 days, triggering the backstop indicator which indicates a significant increase in credit risk. However, this default was due to a temporary cash shortfall caused by a one-off event and the company has remedied this by regularising its repayments before the reporting date. Therefore, the bank has assessed that the one-off delay in repayment by itself does not represent a significant increase in credit risk. The bank has determined the internal credit rating of the loan as 3 on the reporting date. Movement of the internal credit risk rating from 2 to 3 does not reflect a 'significant increase in credit risk'. Accordingly, the bank would continue to compute the loss allowance on the loan based on the 12-month ECL.

M Ltd.

M Ltd. is a relatively new entrant to the steel sector and has been adversely affected by changes in economic conditions. This is reflected in a decline in its financial performance and significant delays in loan repayment. Its internal credit risk rating has been downgraded based on these indicators. A comparison of the internal credit risk rating on initial recognition of the loan and that as on the reporting date indicates a significant increase in credit risk. The loans advanced to M Ltd. would therefore be transferred to stage 2 and a loss allowance recognised based on lifetime ECL.

A Ltd.

A delay in the implementation of A Ltd.'s project has had a detrimental impact on its estimated future cash flows. This has resulted in significant financial difficulties and a breach of its contractual obligations in the form of defaults in repayment of its loan to the bank. The bank is now in the process of restructuring A Ltd.'s loan. These factors have led the bank to assess that the loans are credit-impaired and should, therefore, be transferred to stage 3 for determining the impairment allowance. The bank should, therefore, recognise lifetime expected credit losses on this loan.



Consider this....

- If the credit risk on financial instruments for which lifetime expected credit losses have been recognised subsequently improves so that the requirement for recognising lifetime expected credit losses is no longer met, then the loss allowance is measured at an amount equal to 12-month expected credit losses. Ind AS 109 requires an entity to adopt a policy to determine the period over which it would observe the quantitative/qualitative indicators, which resulted in a significant increase in credit risk. Post this period, where there is sufficient evidence that there is no longer a significant increase in credit risk, the related financial asset may be transferred back to stage 1. However, if a significant increase in credit risk was assessed based on backstop indicators (e.g. days past due), the entity would be required to observe these indicators until the borrower is financially stable.
- The assessment of whether there has been a significant increase in credit risk is made relative to expectations on initial recognition, irrespective of whether a financial instrument has been repriced to reflect an increase in credit risk after initial recognition. For example, certain debt instruments include features under which the credit spread resets when their credit rating changes. In assessing whether there has been a significant increase in credit risk in respect of these instruments, an entity should consider the relative increase in credit risk since initial recognition, rather than from the date of credit spread reset.
- The recent RBI notifications relating to enhanced provisioning requirements for assets advanced to stressed sectors and disclosures of divergence in provisioning levels are directionally consistent with Ind AS principles.
- For revolving credit facilities (that include both a loan and an undrawn commitment), changes in usage of the facility should be closely monitored and modelled into the ECL computation. This is because borrowers may tend to drawdown funds close to the facility limit just prior to an imminent default.
- In performing a staging assessment, banks may bifurcate loans into homogenous segments based on their shared credit risk characteristics. Accordingly, a portfolio of loans may be segmented into companies that are 'low credit risk' (for which no staging assessment may be required), and other segments that include performing accounts, watch list accounts, companies whose financial performance has deteriorated, etc.





Loans and investments by companies under the Companies Act, 2013



This article aims to:

- Provide an overview of the provisions of the Companies Act, 2013 regarding loans and investments made by companies along with highlighting the related provisions of the Listing Regulations.



Introduction

Inter-corporate loans and investments are important sources of funds for every Indian company. The Companies Act, 2013 (2013 Act) contains stringent provisions for providing loans to directors and companies in which directors are interested. Additionally, the 2013 Act provides guidance on loans, securities and guarantees given to subsidiaries. In the case of non-compliance from the requirements of the 2013 Act, penal provisions would apply not only on the lending company but also on the borrowing company.

Companies can also make investments in other entities as per Section 186 of the 2013 Act.

In this article, we provide an overview of the requirements of the 2013 Act when a company provides loans to directors (Section 185) and investments made by companies (Section 186). Additionally, we will also highlight the related key provisions of the Securities and Exchange Board of India (SEBI) (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations).

Restriction on loans to directors by a company – Requirements of Section 185 of the 2013 Act

A company cannot advance any loan, including loan represented by a book debt, directly or indirectly to any of its directors or to any other person in whom the director is interested¹. Such a restriction also extends to any guarantee given or security provided in connection with a loan.

The restriction is intended to prevent the directors from abusing their position of trust to grant loans/ give guarantees/provide security in respect of loans for themselves or for any other person in whom such directors are interested at the cost of the company.

Despite the above restriction, companies are allowed to advance loan or provide guarantee/ security in the following scenarios:

- **Loan given by a private company²:** No restriction on loan given by a private company, if it meets all the given conditions:
 - i. No other body corporate has invested in its share capital
 - ii. Its borrowings from banks/ financial institutions/any body corporate is less than twice of its paid-up share capital or INR50 crore, whichever is lower

iii. No default in repayment of such borrowings subsist at the time of making transactions under Section 185 of the 2013 Act.

- **Loan to MD/WTD:** Any loan given to a Managing Director (MD) or a Whole Time Director (WTD) provided the amount of loan has been given as a part of conditions of service extended by the company to all its employees or has been given in pursuance of any scheme approved by the members by a special resolution.
- **Loan given in normal course of business:** Loans or guarantees for securities provided by the company in its ordinary course of business for the due repayment of any loan at an interest rate not less than the bank rate declared by the Reserve Bank of India (RBI).
- **Loan/guarantee by a holding company to its wholly-owned subsidiary:** Any loan, guarantee or security given by a holding company to its wholly owned subsidiary subject to the condition that the amount of loan should be utilised by the subsidiary only for its principal business activities.
- **Guarantee for loan taken by subsidiary from bank:** Any guarantee given or security provided by a holding company in respect of loan made by any bank or financial institution to its subsidiary subject to the condition that the amount of loan should be

utilised by the subsidiary only for its principal business activities.

Therefore, Section 185 does not apply to private companies (subject to certain conditions). Additionally, a company can provide guarantee or security on loan taken by any subsidiary (for its principal business activities) but it cannot grant a loan to a subsidiary that is not wholly-owned. Further, loans can be given to MD/WTD as a part of conditions of service or in pursuance of a scheme approved by a special resolution.

Investments by a company

In India, companies can make investments in assets or other entities subject to the requirements of the 2013 Act. The following are the conditions:

- a. **Maximum rate of interest:** The rate of interest on loan should not be lower than the prevailing yield of one year, three year, five year or 10 year government security closest to the tenor of the loan.
- b. **No default in repayment of deposits:** The company is not allowed to give any loan/ guarantee/security or make any acquisition if it has defaulted in the repayment of any deposits accepted before or after the commencement of the 2013 Act or payment of interest thereon till such default is subsisting.

1. Any other person in whom director is interested' means:

- i. Any director of the lending company or of a company which is its holding company
- ii. Any partner or relative of director given in (i) above
- iii. Any firm in which any such director or relative is a partner
- iv. Any private company of which any such director is a director or member
- v. Any body corporate in which not less than 25 per cent of the total voting power may be exercised or controlled by any such director, or by two or more directors together at a general meeting
- vi. Any body corporate, the Board of Directors (BOD), managing director or manager whereof is accustomed to act in accordance with the directions or instructions of the BOD, director or directors of the lending company.

2. MCA notification no. G.S.R. 464(E) dated 5 June 2015.

c. Investments to be held in its own name: All investments made or held by a company in any property, security or other asset should be in the company's own name except shares in subsidiary which could be in the name of any nominee or nominees of the company to ensure that the number of members of subsidiary is not reduced below the statutory limit.

However, such a provision will not prevent a company from undertaking the following transactions:

- a. Deposit of any shares or securities for the collection of any dividend or interest payable with a bank
- b. Deposit, transfer or holding shares or securities in the name of the State Bank of India (SBI) or a scheduled bank
- c. Deposit or transfer of any shares or securities by way of security for the repayment of any loan advanced to the company or the performance of any obligation undertaken by it
- d. Holding investments in the name of a depository when such investments are in the form of securities held by a company as a beneficial owner.

Additionally, companies are required to maintain a register in Form MBP 3 containing particulars of investments in shares or securities beneficially held by the company but not held in its own name along with the reasons for not holding them in its own name and the relationship or contract under which such investments are held in the name of any other person.

d. Investments through two layers of investment companies:

A company is not allowed to make investment through more than two layers of investment companies³. However, the restriction of two layers of investment companies⁴ is not applicable in the following cases:

- i. A company acquires any other company incorporated in a country outside India if such other company has investment subsidiaries beyond two layers as per the laws of such country
- ii. A subsidiary company having any investment subsidiary for the purposes of meeting the requirements under any law or under any rule or regulation framed under any law for the time being in force.

e. Special resolution or ordinary resolution:

In certain cases, companies while making an investment would need to get necessary approvals by way of special resolution. (Refer 'transactions requiring approval by a special resolution' section below).

f. Maintenance of register: A register (either manually or in electronic mode) in Form MBP 2 containing particulars of loans and guarantees given, securities provided and acquisitions made is required to be maintained by every company giving loan/ guarantee or providing security or making any acquisition.

Transactions requiring approval by a special resolution

While making investments, a company is not allowed to enter into certain transactions if the amount involved in the transaction

exceeds 60 per cent of paid-up share capital, free reserves and securities premium account or 100 per cent of its free reserves and securities premium account, whichever is more. However, if a special resolution⁵ is passed at a general meeting then a company could be allowed to make investments above the thresholds given in Section 186. Those transactions are as follows:

- a. Giving loans to any person/body corporate
- b. Giving guarantee or providing security in connection with the loan taken by person/body corporate
- c. Acquisition by way of subscription, purchase or securities of any body corporate.

Additionally, companies are required to disclose full particulars of the loans given, investments made or guarantee given or security provided along with the purpose for which such amounts have been proposed to be utilised by the recipient.

However, the provisions of Section 186 are not applicable to the loans and/or advances made by companies to their employees (other than MD or WTD which are governed by Section 185) subject to the condition that such loans/ advances have been given in accordance with the conditions of service applicable to the employees and are commensurate with the remuneration policy, in cases where such policy is required to be formulated⁶.

3. The Companies (Amendment) Bill, 2016 proposes to omit this restriction. However, the Ministry of Corporate Affairs (MCA) through its notice dated 28 June 2017 proposed that the requirement for making investment through not more than two layers of investment companies would continue to apply.

4. An 'investment company' means a company whose principal business is the acquisition of shares, debentures or other securities.

5. The special resolution should specify the total amount up to which the BOD are authorised to give such loans/ guarantee, to provide such security or make such acquisition.

6. MCA general circular no. 04/2015 dated 10 March 2015.

Additionally, approval by way of special resolution is not required in case a holding company has:

- a. Given loan/guarantee or has provided security to its wholly owned subsidiary company or a joint venture company, or
- b. Acquired by way of subscription, purchase or otherwise, the securities of its wholly owned subsidiary.

The exemption is subject to disclosure of the details of such loans/guarantee or security or acquisition in their financial statements.

Transactions exempt from the requirements of Section 186

The provisions of Section 186 of the 2013 Act (except restriction on layers of investment companies) do not apply to following situations:

- a. Loan/guarantee/security provided by a banking company or an insurance company or a housing finance company in the ordinary course of its business or by a company engaged in the business of financing of companies or of providing infrastructural facilities
- b. Acquisition made by:
 - i. A Non-Banking Financial Company (NBFC) registered with Reserve Bank of India

(RBI) with acquisition of securities as its principal business

- ii. Company with acquisition of securities as its principal business, or
- iii. A banking company, insurance company or a housing finance company making acquisition of securities in the ordinary course of its business.
- c. Acquisition of shares allotted under rights issue (Section 62(1)(a)).

Requirements prescribed under the Listing Regulations

Listing Regulations do not contain specific provisions on inter-corporate loans/investments or loans to directors. However, they prescribe the following requirements in relation to loans and investment by companies:

- **Review of loans by audit committee:** The role of audit committee should, *inter alia*, include scrutiny of inter-corporate loans and investments.
- **Information to be placed before BOD:** Minimum information required to be

placed before the BOD of a listed entity should, *inter alia*, include sale of investments by the entity.

- **Disclosure in annual report:** Annual report of every debt and equity listed entity (except listed banks) should, *inter alia*, disclose the following with respect to amounts at the year end and the maximum amount of loans/advances/investments outstanding during the year:
 - *In case of holding entity:* Loans and advances in the nature of loans to subsidiaries/associates/firms or entities in which

directors are interested by name and amount.

Additional disclosure of investments by the loanee in the shares of parent entity and subsidiary, when the entity has made a loan or advance in the nature of loan.

- *In case of subsidiary:* Same disclosures as applicable to the parent entity in the accounts of subsidiary entity.

7. Business of financing of companies with regard to NBFC registered with RBI should include 'business of giving of any loan to a person or providing any guaranty or security for due repayment of any loan availed by any person in the ordinary course of its business'.

Recommendations of the Companies Law Committee (CLC) and Companies (Amendment) Bill, 2017 (Amendment Bill, 2017)⁸

The CLC and the Amendment Bill, 2017 proposed the following with respect to loans and investments by companies and loans to directors:

- Allow loans to person in whom directors are interested: Companies should be allowed to advance loans to any other person in whom the director is interested, subject to prior approval of the company by a special resolution.
- Align rate of interest: The CLC and the Amendment Bill, 2017 proposed that interest rate prescribed in the proviso (b) to

Section 185(1) (i.e. interest rate to be at par with the bank rate declared by the RBI) should be aligned with the rate provided under Section 186(7) of the 2013 Act (i.e. government security rate).

Additionally, CLC proposed that the loan given to a foreign entity should be at the effective yield rate which should not be less than the rate provided under Section 186(7).

- Removal of restriction on layers of companies: CLC proposed to remove restrictions on layers of investment companies on the ground that sufficient safeguards have been built into the oversight mechanism of SEBI and the

stock exchanges. In line with the recommendations made by the CLC, the Companies (Amendment) Bill, 2016 also proposed to omit such restrictions.

However, the MCA has decided to retain the requirements of Section 186(1) and accordingly, the Amendment Bill, 2017 does not propose to remove the restriction on layers of investment companies.

Consider this....

- A company is not allowed to make investment through more than two layers of investment companies. However, such a provision does not restrict a company from acquiring any other company incorporated outside India if such other company has investment subsidiaries beyond two layers as per laws of such country or there are requirements under any law or rule which requires existence of such subsidiaries.
- A company is allowed to provide a loan to the MD or the WTD provided the amount has been given as a part of conditions of service given by the company to all its employees or has been given in accordance with any scheme approved by the members by a special resolution.
- A company is allowed to make loans to any person, body corporate, give guarantee or provide security in connection with the loan up to 60 per cent of the paid-up capital, free reserves and securities premium account or 100 per cent of the free reserves and securities premium account, whichever is higher, without any special resolution by the members of the company.
- Similarly, no approval by way of a special resolution is required in case a holding company gives a loan/guarantee or provides security to its wholly owned subsidiary company or acquires by way of subscription, purchase or otherwise, the securities of its wholly owned subsidiary.



8. Companies Amendment Bill, 2017 has been passed in the Lok Sabha on 27 July 2017. Approval by the Rajya Sabha is pending.



Replacement of employee stock options in a business combination



This article aims to:

- Provide an overview on the accounting principles relating to replacement of employee stock options in a business combination transaction with the help of an example.

Employee compensation plans have evolved dynamically over the past few years and issuance of stock options to employees by an entity has become a common feature. It is not limited to start-up and technology companies but the traditional manufacturing sector may also issue share-based payment awards. On fulfilment of stipulated conditions, such as the entity meeting certain financial targets over a period of time or the employee servicing the entity for a specified number of years, etc. employees could be entitled to *share-based payment* awards. For entities following the Indian Accounting Standards (Ind AS) framework, Ind AS 102, *Share-based Payment* governs the accounting of employee stock options. In case of a business combination, the guidance provided in Ind AS 103, *Business Combinations* is relevant when an acquiring entity obtains an entity which has issued share-based payment awards to its employees.



Accounting principles for replacement of employee stock options in a business combination

When a business combination takes place, there could be three scenarios in relation to share-based payment awards given by the acquiree company to its employees. Those three scenarios are as follows:

- Voluntary replacement: An acquirer could voluntarily issue awards to employees of the acquiree to replace awards that otherwise would have expired at the acquisition date.
- Mandatory replacements: An acquirer could be obliged to issue replacement awards to employees of the acquiree in exchange for their existing unexpired awards.
- Unreplaced awards: An acquirer may not replace existing awards with the employees of the acquiree.

Accounting of each of the above scenario is different and therefore, entities need to carefully evaluate whether it is obligatory on the part of the acquirer to issue its own stock options against the stock options already issued to the employees of the acquiree as part of the business combination.

Voluntary replacement of expired acquiree awards

In a certain business combination, a share-based payment award held by the employees of the acquiree could expire i.e. the employees are no longer entitled to the share-based payment and the awards lapse. However, if such awards are replaced voluntarily by the acquirer, then all market-based measures of the replacement awards would be recognised as post-combination remuneration cost. It is important to note that in such a situation none of the market-based measures of

the replacement awards would be attributed as consideration transferred in the business combination.

The amount attributable to post-combination service would be recognised in accordance with Ind AS 102.

Mandatory replacement of acquiree awards

In certain business combinations, an acquirer could be mandatorily required to issue replacement awards to employees of an acquiree in exchange for unexpired share-based payment awards issued previously by the acquiree. In such a situation, such exchanges would be accounted as modifications of share-based payment awards under Ind AS 102.

As a result, the market-based measure of the share-based payment awards could be allocated to the following:

- Business combination cost: All or a portion of the amount of the acquirer's replacement awards is included in measuring the consideration transferred in the business combination.
- Post combination service: In some instances, a portion of the value of the replacement awards is allocated to post-combination service and hence, accounted for separately from the business combination.

Ind AS 103 provides a detailed formula for the method of determining the portion of a replacement award that would be part of the 'consideration transferred for the acquiree' and the portion that is 'remuneration for post-combination service'.

Unreplaced awards

It is important to note that Ind AS 103 contains guidance about equity settled acquiree awards that are not replaced by share-based payment

awards of the acquirer (unreplaced awards). This guidance does not apply to cash-settled acquiree awards.

The accounting requirements for unreplaced acquiree awards fall into two categories:

- Vested awards: Acquiree awards that were vested at the date of acquisition
- Unvested awards: Acquiree awards that were not vested at the date of acquisition.

Vested awards

For equity-settled unreplaced acquiree options that are vested but unexercised at the acquisition date, such awards would form part of the non-controlling interests in the acquiree. These would be measured at their market-based measure at the date of acquisition in accordance with Ind AS 102.

Unvested awards

For equity-settled unreplaced acquiree award that are not vested at the date of acquisition, such awards would be measured at their market-based measure as if the date of acquisition were the grant date under Ind AS 102.

Market-based value of unreplaced acquiree award would be allocated to pre-combination service and post combination service.

In determining the portion of the market-based measure that is allocated to pre-combination service, all of the relevant data regarding the probability of meeting vesting conditions other than market conditions are taken into account. If the acquiree's awards have non-market performance conditions, then the entity needs to determine whether non-market performance conditions are probable or not at the date of acquisition.

If non-market performance conditions that are not probable of being met as at the date of acquisition, then no amount is allocated to pre-combination service and therefore, no amount is allocated to Non-Controlling Interest (NCI).

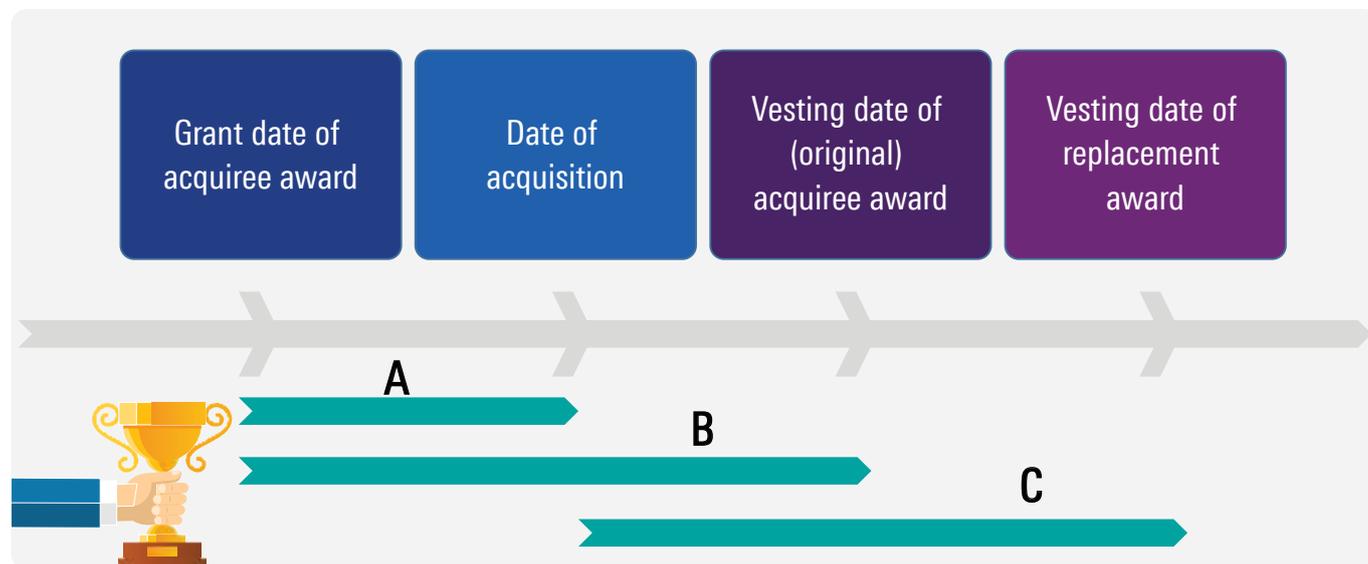
If the non-market performance condition is probable of being met such that a portion of the market-based measure is allocated to a pre-combination service, then the market-based measure of the unvested share-based payment transaction is allocated to the pre-combination service, and therefore to NCI, based on the ratio of the portion of the vesting period completed to the greater of the total vesting period or the original vesting period of the unreplaced awards. The balance is allocated to the post-

combination service. The attribution formula for unreplaced awards is the same as the formula for replaced awards.

Formula to determine the amount of the market-based measure for mandatory replacement awards

The amount of the market-based measure of the replacement awards treated as consideration transferred is determined in the following manner:

1. Determine at the date of acquisition, in accordance with Ind AS 102:
 - the market-based measure of the acquiree's awards (FVa); and
 - the market-based measure of the replacement awards (FVr).
2. Determine:
 - the period for which services have been provided by the employees before the date of acquisition (A in the diagram below)
 - the original vesting period of the acquiree's awards (B in the diagram below)
 - the post-combination vesting period, if any, for the replacement awards (C in the diagram below), and
 - the greater of the total vesting period (the sum of A plus C) and the original vesting period of the acquiree's awards (B).



(Source: KPMG IFRG Ltd's publication Insights into IFRS, 13th edition)

The total vesting period of the original awards may be longer than the sum of the pre-combination period for which the service has been provided plus the post-

combination vesting period of the replacement awards. However, in other cases a change-in-control clause is included in the original terms of an acquiree award and the

clause is triggered by an acquisition of the acquiree such that unvested awards immediately vest at the date of acquisition.

3. Calculate the portion of the replacement awards attributable to a consideration transferred in the business combination as the product of:

- the market-based measure of the acquiree's awards at the date of acquisition, and
- the ratio of the pre-combination vesting period to the greater of the total vesting period and the original vesting period of the acquiree's awards.

Amount included in consideration transferred = A/Greater of (A+C) and B

Any remaining amount of the market-based measure of the replacement awards after deducting the amount attributed to consideration transferred is treated

as post-combination remuneration cost.

Let us understand the above principles through an example.

On 1 April 2015, company S granted equity-settled share-based payment awards with a grant date fair value of INR100 to its employees, subject to a three-year service condition. Company P buys 100 per cent of S's shares on 1 April 2017, and as part of the share purchase agreement duly approved by the legal authorities, is required to issue equity-settled replacement awards to S's employees. At the date of acquisition, the market-based measure of the original awards is INR120; the market-based measure of the replacement awards is INR140. The replacement awards have a one-year vesting condition.

Assuming that all employees are expected to meet the service condition, the following points are relevant to determining the amount attributed to the pre-combination service:

- The period for which service has been provided by S's employees before the date of acquisition is two years.
- The vesting period of the original (acquiree) awards is three years.
- The vesting period of the replacement awards is one year.
- The total vesting period and the original vesting period are both three years. The greater of those two periods is therefore also three years.

In its consolidated financial statements, P records the following entries.

Entry	Amount INR	Note
Consideration transferred	Dr 80	1
To equity	Cr 80	
(Entry passed to recognise replacement awards attributed to pre-combination service as part of consideration transferred)		
Remuneration cost	Dr 60	2
To equity	Cr 60	
(To recognise replacement awards attributed to post combination service)		

Notes:

1. The computation of the amount attributed to the pre-combination service is computed as follows:

$$120^A \times 67\% (2 \text{ years}/3 \text{ years})^B = 80$$

A. Market-based measure of acquiree awards at the acquisition date

B. Ratio of services rendered as at 1 April 2017 compared with the greater of the original vesting period (3 years) and the sum of the pre-combination period for which service has been provided (2 years) plus the post combination vesting period (1 year); both the periods are three years

2. The computation of the amount attributed to the post-combination service is computed as follows:

$$140^C - 80^D = 60$$

A. Market-based measure of replacement awards at the date of acquisition

B. Amount attributed to the pre-combination service (see above).

(Source: KPMG IFRG Ltd's publication Insights into IFRS, 13th edition)

Considerations on first-time adoption of Ind AS

Ind AS 101, *First-time adoption of Indian Accounting Standards*, provides certain exemptions and exceptions to facilitate smooth transition from Indian Generally Accepted Accounting Principles (GAAP) to Ind AS. On transition to Ind AS, a company has the following three options in relation to the

business combination transactions before the transition date:

- Not to restate business combinations before the transition date
- Restate all past business combinations before the transition date, or
- Restate all past business combinations done after a chosen date, prior to the transition date.

In case the entity does not avail the exemption under Ind AS 101 on the transition date and restates the business combination under Ind AS 103, it should additionally evaluate the accounting implications of the replacement of the employee stock options, among other things.

Consider this....

- When a portion of the market-based measure of the employee stock options is attributed to a pre-combination period, it is considered as part of the consideration paid in a business combination's transactions, therefore, directly adding to the goodwill or reducing the gain. The acquirer company will also have to make adequate disclosures in the financial statements in regard to the employee stock options granted as part of business combination. Additional thoughts should also be spared to evaluate if the stock options granted both by the acquirer and the acquiree are cash-settled or equity-settled. As on the acquisition date, all other requirements of Ind AS 102 are required to be taken into account such as, how many options shall eventually vest, etc.
- The requirements to determine the portions of a replacement award attributable to the pre-and post-combination service apply regardless of whether the replacement award is classified as cash-settled or as equity-settled in accordance with Ind AS 102.
- The recognition of remuneration cost in respect of share-based payment awards is based on the best available estimate at the date of acquisition of the total number of replacement awards expected to vest. Accordingly, determination of the amount of replacement awards to be attributed to the pre- and post-combination service takes into account the expected rate of forfeitures of the replacement awards arising from expected failure to meet vesting conditions other than market conditions.





Regulatory updates

ICAI issued a Guidance Note on Division II - Ind AS Schedule III to the Companies Act, 2013

Background

The Schedule III to the Companies Act, 2013 (2013 Act) became applicable to all companies for the preparation of financial statements for financial years beginning on or from 1 April 2014. The Schedule III provides general instructions for preparation of the balance sheet and the statement of profit and loss of a company.

The Ministry of Corporate Affairs (MCA) through a notification dated 16 February 2015 issued the Companies (Indian Accounting Standards) Rules, 2015 (Ind AS Rules) which laid down a road map for entities (other than insurance entities, banking entities and Non-Banking Financial Companies (NBFCs)) (corporate road map) for implementation of Ind AS (converged with IFRS) in a phased manner.

On 6 April 2016, MCA amended Schedule III to include general instructions for preparation of financial statements of a company whose financial statements are required to comply with Ind AS. The amendment divides Schedule III into two parts i.e. Division I and II:

- Division I is applicable to a company whose financial statements are required to comply with the current accounting standards
- Division II is applicable to a company whose financial statements are drawn up in compliance with Ind AS (Ind AS Schedule III).

The Institute of Chartered Accountants of India (ICAI) on 20 April 2017 issued an exposure draft on the Guidance Note (GN) on Division II - Ind AS Schedule III to the 2013 Act which was open for comments until 30 April 2017.

New development

The ICAI on 27 July 2017 issued the GN on Division II - Ind AS Schedule III to the 2013 Act. The primary focus of the GN is to provide guidance in the preparation and presentation of financial statements in accordance with various aspects of Ind AS Schedule III, for entities adopting Ind AS. The GN has been structured in the following categories:

- Guidance on each of the line item of the balance sheet, statement of profit and loss
- Major differences in Division I and Division II of the Schedule III to the 2013 Act



- Illustrative format for stand-alone financial statements and consolidated financial statements
- Illustrations that provide guidance on application of the principles provided in the GN.

Please refer to KPMG in India's IFRS Notes dated 17 August 2017 which provides an overview of some of the significant clarifications/guidance provided in the GN issued by the ICAI.

(Source: GN on Division II - Ind AS Schedule III issued by ICAI, July 2017 edition)

Ind AS Transition Facilitation Group (ITFG) issues Clarifications Bulletin 11

The ITFG in its meeting considered certain issues received from the members of ICAI and issued its Bulletin 11 on 1 August 2017 to provide clarifications on nine issues in relation to the application of Ind AS.

The ITFG provided clarification on the following issues relating to the application of Ind AS:

1. Computation of net worth of a company to assess applicability of Ind AS
2. Applicability of Accounting Standard Interpretations (ASI) issued under previous GAAP to situations of tax holiday under Ind AS
3. Calculation of earnings per share by a subsidiary company that is not wholly owned by its parent
4. Measurement of investments in subsidiaries, joint ventures and associates at the end of the first Ind AS financial reporting period
5. Accounting treatment of exemption from duties and taxes under export promotion capital goods scheme
6. Consolidation of financial statements of a subsidiary following a different method of depreciation
7. Applicability of Ind AS to non-corporate entities
8. Treatment of enabling assets in the financial statements of an entity
9. Disclosure of sitting fees paid to independent and non-executive directors.

Please refer KPMG in India's IFRS Notes dated 21 August 2017 which provides an overview of the issues discussed in ITFG's Bulletin 11.

(Source: Bulletin 11 issued by ITFG of ICAI dated 1 August 2017)

ICAI issued exposure draft of Ind AS 116, Leases

Background

The MCA through a notification dated 16 February 2015 issued the Ind AS Rules which laid down a corporate road map for implementation of Ind AS converged with IFRS in a phased manner. Accordingly, MCA notified 40 Ind AS which included Ind AS 17, *Leases*.

Internationally, on 13 January 2016, the International Accounting Standards Board (IASB) issued IFRS 16, *Leases*. The new standard represented a fundamental shift in accounting for leases, specifically for lessees. Additionally, it is expected to increase transparency and comparability of published financial information as analysts and investors would be able to see a company's own assessment of its lease liabilities, calculated using a prescribed methodology under Ind AS.

IFRS 16 is effective from 1 January 2019, with early application being permitted (as long as IFRS 15, *Revenue from Contracts with Customers* is also applied).

New development

On 18 July 2017, the Accounting Standards Board (ASB) of ICAI issued an Exposure Draft (ED) of Ind AS 116, *Leases*. Ind AS 116 is largely converged with IFRS 16.

Ind AS 116 is expected to replace Ind AS 17 from its proposed effective date, being annual periods beginning on or after 1 April 2019.

The ED sets out the principles for the recognition, measurement, presentation and disclosure of leases. The objective of the ED is to ensure that lessees and lessors provide relevant information in a manner that faithfully represents those transactions. This information gives a basis for users of financial statements to assess the effect that leases will have on the financial position, financial performance and cash flows of the entity.

Comments on the ED may be submitted to ICAI by 31 August 2017.

Please refer to KPMG in India's IFRS Notes dated 28 July 2017 which provides an overview of the key requirements of Ind AS 116 as proposed in the ED and highlights the key differences vis-à-vis IFRS 16.

(Source: Exposure draft on Ind AS 116 issued by ICAI dated 18 July 2017)

CBDT issues FAQs on computation of book profit for levy of MAT and proposes amendment to Section 115JB

Background

The Finance Act, 2017 provided a separate formula for computation of book profit for companies that prepare financial statements under Ind AS. Accordingly, Minimum Alternate Tax (MAT) would be calculated using the profits as per the statement of profit and loss before Other Comprehensive Income (OCI), as the starting point. The Finance Act, 2017 also provides certain adjustments to book profits for MAT computation.

New development

The Central Board of Direct Taxes (CBDT) received a number of queries on various aspects of computation of MAT under Ind AS. These matters were referred to an expert committee. On 25 July 2017, CBDT issued clarifications in the form of Frequently Asked Questions (FAQs) on issues relating to the levy of MAT for Ind AS compliant companies along with the proposed amendment in the Income-tax Act, 1961.

Please refer to KPMG in India's IFRS Notes dated 26 July 2017 which provides an overview of the following:

1. Clarifications in the form of Frequently Asked Questions (FAQs) on issues relating to the levy of MAT for Ind AS compliant companies
2. Proposal for amendment to Section 115JB of the IT Act in relation to Ind AS compliant companies.

(Source: CBDT press release dated 25 July and CBDT circular 24/2017 dated 25 July 2017)

CBDT amends the report on computation of book profits for Ind AS compliant companies

To enable the Ind AS compliant companies to report and accountants to certify the Form No. 29B appropriately, on 18 August 2017, CBDT has issued revised Form No. 29B and aligned it with the requirements of Ind AS.

The revised Form No. 29B incorporates two new parts in it. They are as follows:

- **Part B - 'Details of the amount required to be increased or decreased in accordance with sub-section (2A) of Section 115JB':** Part B of the form is applicable only where the financial statements of the company are drawn up in compliance with the Ind AS specified in Annexure to the Ind AS Rules for the Previous Year (PY) or any part thereof.
- **Part C - 'Details of the amount required to be increased or decreased in accordance with sub-section (2C) of Section 115JB':** Part C of the form is also applicable only where the financial statements of the company are drawn up in compliance with the Ind AS specified in Annexure to the Ind AS Rules for the PY or any part thereof. However, this part will be filled up for the year of convergence and each of the following four PYs only.

The adjustments to be reported under Part B and Part C of the form is in accordance with the adjustments comprised in Section 115JB(2A) and 115JB(2C) of the IT Act.

The revised form is applicable from the date of publication of the notification in the official gazette i.e. 18 August 2017.

Please refer KPMG in India's IFRS Notes dated 21 August 2017 which

provides a detailed analysis of recent notification of CBDT

(Source: CBDT notification G.S.R. 1028(E) dated 18 August 2017)

SEBI mandates disclosures of defaults on repayment of loans from banks by listed entities

Background

The Securities and Exchange Board of India (SEBI) on 2 September 2015 issued the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations). The Listing Regulations require disclosure of material events/information by listed entities to stock exchanges. Specific disclosures are required under the Listing Regulations on certain matters such as delays and default in payment of interest/principal including:

- Listed non-convertible debentures
- Listed non-convertible redeemable preference shares
- Foreign Currency Convertible Bonds (FCCBs)
- Any other similar types of debt securities.

The Listing Regulations do not require the above disclosures to be provided in respect of loans from banks and financial institutions.

New development

The SEBI, through its circular dated 4 August 2017 has mandated listed entities who have defaulted in payment of interest/instalment obligations on loans from banks and financial institutions, debt securities (including commercial paper), etc. to provide a disclosure of defaults to the stock exchanges within one working day from the date of the default in the manner prescribed in the circular.

This circular is effective from 1 October 2017.

Overview of the SEBI circular

Applicability

- The circular will apply to entities which have listed the following securities on the stock exchanges:
 - Specified securities i.e. equity and convertible securities
 - Non-convertible debt securities
 - Non-convertible and redeemable preference shares.
- The circular applies to a listed entity covered above which defaults in payment of interest/ instalment obligation on any of the following:
 - Loans from banks and financial institutions
 - Debt securities (including commercial paper)
 - Medium Term Notes (MTNs)
 - FCCBs
 - External Commercial Borrowings (ECBs), etc.
- The term 'default' for the purpose of this circular will mean non-payment of interest or principal amount in full on the pre-agreed date.

Formats for disclosures

The SEBI circular prescribes two different reporting formats for:

1. Disclosures in case of first instance of default (to be reported within one day of default)

2. Disclosures in case there is any outstanding amount under default as on the last day of the quarter (to be reported within seven days from the end of the quarter).

Timing of disclosures: A listed entity is required to make the prescribed disclosure within one working day from the date of default at the first instance of default in the prescribe format. Additionally, a listed entity is required to report within seven days from the end of the quarter in case there is any outstanding amount under default as on the last date of any quarter.

Inform credit rating agencies:

Listed entities are required to separately provide information pertaining to defaults to the concerned credit rating agencies in a timely manner and as may be prescribed by SEBI from time to time.

(Source: SEBI circular CIR/CFD/CMD/93/2017 dated 4 August 2017 and KPMG in India's First Notes dated 16 August 2017)

Disclosure of divergence in asset classification and provisioning by banks

Background

The Reserve Bank of India (RBI) through its notification dated 18 April 2017, requires disclosures by banks in a prescribed format in certain cases of divergence in asset classification and provisioning.

New development

In light of the above mentioned RBI notification, SEBI through its circular dated 18 July 2017, has mandated banks having listed specified securities to disclose the divergences in asset classification and provisioning to stock exchanges in the prescribed format, when:

- The additional provisioning requirements assessed by RBI exceed 15 per cent of the published net profits after tax for the reference period and/or
- The additional gross NPAs identified by RBI exceed 15 per cent of the published incremental gross NPAs for the reference period.

The above mentioned disclosures should be placed as an Annexure to the annual financial results filed with the stock exchanges in accordance with SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. Such disclosures should be made along with the annual financial results filed immediately following communication of such divergence by RBI to the bank.

(Source: SEBI circular CIR/CFD/CMD/80/2017 dated 18 July 2017)



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IFRS Notes

CBDT amends the report on computation of book profits for Ind AS compliant companies



22 August 2017

The Finance Act, 2017 provided a separate formulae for computation of book profit for the companies that prepare financial statements under Ind AS. Accordingly, Minimum Alternate Tax (MAT) would be calculated using the profits as per the statement of profit and

loss before Other Comprehensive Income (OCI), as the starting point. The Finance Act, 2017 also provides certain adjustments to book profits for MAT computation.

To enable the Ind AS compliant companies to report and accountants to certify the Form No. 29B appropriately, on 18 August 2017, the Central Board of Direct Taxes (CBDT) has issued revised Form No. 29B and aligned it with the requirements of Ind AS. The adjustments to be reported under revised form is in accordance with the adjustments comprised in Section 115JB(2A) and 115JB(2C) of the IT Act.

This issue of IFRS Notes provides an overview of changes incorporated in revised Form No. 29B.

First Notes

SEBI mandates disclosures of defaults on repayment of loans from banks by listed entities



16 August 2017

The SEBI, through its circular dated 4 August 2017 has mandated listed entities who have defaulted in payment of interest/installment obligations on loans from banks and financial institutions, debt securities (including commercial paper), etc. to provide a disclosure of defaults to the stock exchanges within

one working day from the date of the default in the manner prescribed in the circular.

This circular is effective from 1 October 2017.

This issue of First Notes provides an overview of the new SEBI disclosure requirements for listed entities in case of default in repayment of loans taken from banks and financial institutions.



Special session: Webinar on FAQs on computation of book profit for levy of MAT and proposed amendment to Section 115JB

In our recent call on 3 August 2017, we discussed key clarifications on computation of book profit for levy of Minimum Alternate Tax (MAT) issued by the Central Board of Direct Taxes (CBDT) and the proposed amendment to Section 115 JB of the Income Tax Act, 1961 (IT Act).

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