Indian Accounting Standards (Ind AS) mandate preparation of Consolidated Financial Statements (CFS). An important element of preparing CFS is the accounting and presentation of Non-Controlling Interests (NCI). Though owners of NCI do not control an entity, they still represent equity interest. In this edition of Accounting and Auditing Update (AAU), we highlight certain practical application areas associated with the accounting and presentation of NCI e.g. manner of attribution of profits and losses, impact of potential voting rights, sale/purchase of equity to/from NCI, etc. The article also captures the detailed disclosure requirements relating each material subsidiary e.g. presentation of summarised financial information, significant restrictions and judgements.

Under the Companies Act, 2013 (2013 Act), depreciation accounting is not based on prescriptive rates but provides indicative rates of depreciation and gives room to entities to apply judgement while estimating the useful lives of the assets. Our article provides an overview of the 2013 Act’s requirements with respect to depreciation and also integrates the guidance provided in the application guide and guidance note on accounting of depreciation issued by the Institute of Chartered Accountants of India (ICAI).

Under Ind AS, goodwill arises when there is a business combination. Additionally, under Ind AS, this asset is no longer amortised but tested for impairment annually. Impairment testing requires entities to exercise considerable judgement and there is a need to use assumptions that represent realistic future expectations. Additionally, certain disclosures relating to goodwill e.g. sensitivity analysis and estimate of recoverable amount are most challenging. Therefore, our article elaborates on the key considerations and disclosures that an entity should focus while conducting a goodwill impairment test.

We also cover a regular round-up of some recent regulatory updates in India and internationally along with an article highlighting key clarifications provided by ICAI in its education material on Ind AS 16, Property, Plant and Equipment.

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

1. Non-controlling interests accounting under Ind AS  
2. Accounting of depreciation under the Companies Act, 2013  
3. Goodwill impairment - key considerations  
4. Educational material on Ind AS 16  
5. Regulatory updates
Non-controlling interests accounting under Ind AS

Introduction

The International Accounting Standards Board (IASB) changed the term ‘minority interest’ to ‘Non-Controlling Interest’ (NCI) in 2008 in the International Financial Reporting Standards (IFRS). The change in terminology reflects the fact that an owner of a minority interest in an entity might control that entity and, conversely, that the owners of a majority interest in an entity might not control the entity. Therefore, NCI is a more accurate description than minority interest of the interest of those owners who do not have a controlling interest in an entity.

Indian Accounting Standards (Ind AS) are converged with IFRS and therefore, Ind AS 110, Consolidated Financial Statements defines NCI as equity in a subsidiary not attributable, directly or indirectly, to a parent. Ind AS 110 requires a parent to present NCI in the Consolidated Financial Statements (CFS) within equity, separately from the equity of the owners of the parent. For example, if a parent owns 80 percent of a subsidiary directly and the remaining 20 percent is owned by a third party, then in the parent’s CFS the 20 percent interest held by the third party is presented as NCI in that subsidiary (within equity). This is because existence of NCI in the net assets of a subsidiary does not give rise to a present obligation, the settlement of which is expected to result in an outflow of economic benefits from the group. It represents equity i.e. residual interest in the assets of the entity after deducting all its liabilities.

On the other hand, Accounting Standards (AS) use the term minority interest and not NCI. AS 21, Consolidated Financial Statements, defines minority interest as that part of the net results of operations and of the net assets of a subsidiary attributable to interests which are not owned, directly or indirectly through subsidiary(ies), by the parent. AS 21 prescribes that while preparing CFS a parent is required to identify and present minority interest separately from liabilities and the equity of the parent’s shareholders. Thus, under AS minority interest is not presented as part of equity.

NCI can be categorised as:

- Present ownership interests that entitle their holders to a proportionate share of the entity’s net assets in liquidation (ordinary NCI)
- All other NCI (other NCI) e.g. equity components of convertible bonds or options under share-based arrangements, etc.
Measurement of NCI

Ind AS 103, Business Combination requires that for each business combination, where an acquirer does not acquire 100 per cent of a subsidiary, then the acquirer can elect on a transaction-by-transaction basis to measure ordinary NCI on initial recognition either at:

- Fair value at the date of acquisition, which means that goodwill, or the gain on a bargain purchase, includes a portion attributable to ordinary NCI; or
- The holders’ proportionate interest in the recognised amount of the identifiable net assets of the acquiree, which means that goodwill, or the gain on a bargain purchase, relates only to the controlling interest acquired.

This accounting policy choice relates only to the initial measurement of ordinary NCI. After initial recognition, the option of measuring ordinary NCI at fair value is not available.

Measurement of other NCI

The accounting policy choice available to ordinary NCI (as explained above) does not apply to ‘other NCI’. Such instruments are measured as prescribed by the relevant Ind AS.

Practical application areas

While preparing CFS, a parent may have to consider some practical application areas while accounting and presenting NCI. Some of the significant areas are as follows:

- Attribution of profit and losses
  
  As per Ind AS 110, an entity is required to attribute the profit or loss and each component of other comprehensive income to the owners of the parent and to the NCI. Additionally, Ind AS requires an entity to allocate the losses incurred by subsidiary between the parent and NCI even if it results in a negative balance of the NCI. Whereas under AS 21, if the losses attributable to minority interest in a subsidiary exceed the minority interest in the equity of the subsidiary, then such excess and further losses are adjusted against the parent’s share, except where the minority has a binding obligation to make good such losses.

- Potential voting rights and the NCI proportion
  
  As per the requirements of Ind AS 110, the determination of control of an entity takes into account potential voting rights that are substantive. However, Ind AS clarifies that NCI is generally based on current ownership interests because this corresponds to the economic interests of the parties.

  This includes in substance current ownership interest i.e. as a result of a transaction that gives it access to the returns associated with an ownership interest. In this case, the proportion allocated to the parent and NCI is determined by taking into account the eventual exercise of those potential voting rights and other derivatives that currently give the entity access to the returns associated with an ownership interest.

- Calculation of Earnings Per Share (EPS)

  For the purpose of calculating EPS based on CFS, the entity would consider profit or loss attributable to the ordinary equity holders of the parent entity and if presented, profit or loss from continuing operations attributable to those equity holders.

  The Ind AS Transition Facilitation Group (ITFG) of the Institute of Chartered Accountants of India (ICAI) in its recent bulletin, Bulletin 11, also reiterated that while calculating EPS, profit or loss attributable to the parent entity refers to profit or loss of the consolidated entity after adjusting profit attributable to NCI.

- Sale/purchase of equity interest to/from NCI

  After a parent has obtained control of a subsidiary, there may be a change in its ownership interest in that subsidiary without losing control.

For example, the parent buys shares from, or sells shares to, NCI or the subsidiary issues new shares or reacquires its shares.

As per Ind AS 110, transactions that result in changes in ownership interests while retaining control are accounted for as transactions with equity holders in their capacity as equity holders. As a result, no gain or loss on such changes is recognised in profit or loss; instead, it is recognised in equity. Also, no change in the carrying amounts of assets (including goodwill) or liabilities is recognised as a result of such transactions.

The interests of the parent and NCI in the subsidiary are adjusted to reflect the relative change in their interests in the subsidiary's equity. As per Ind AS 110, any difference between the amount by which NCI are adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to the owners of the parent. These principles also apply when a subsidiary issues new shares and the ownership interests change as a result.

- Non-reciprocal capital contribution:

  Sometimes an entity receives amounts from shareholders in the form of capital contributions, being either cash or other non-monetary assets, which are non-reciprocal - i.e. no financial or non-financial obligation exists. This may happen, for example, when an entity requires additional financing or is in financial difficulty. Amounts might be received from all shareholders or only certain shareholders. The non-reciprocal capital contributions made by a parent to a non-wholly owned subsidiary should be allocated proportionately to NCI, i.e. they should be accounted for as transactions between shareholders, which have a direct impact on equity.
For example: Company X makes non-reciprocal capital contribution of 100 to its subsidiary, Y, in which it holds a 75 per cent interest. The NCI in Y makes no capital contribution. As per NCI accounting an amount of INR25 is allocated to NCI and INR75 is allocated to parent equity directly in equity in the CFS of X.

• Impairment testing of cash-generating units with goodwill and NCI

Ind AS 36, Impairment of Assets requires an entity to test goodwill acquired in a business combination each year for impairment. The testing for impairment involves comparing the recoverable amount of a Cash Generating Unit (CGU) with the carrying amount of the CGU. An entity may measure NCI at their proportionate interest in the identifiable net assets of the subsidiary (that is a CGU or group of CGUs) at the date of acquisition. Therefore, goodwill attributable to NCI would not be recognised in the parent’s CFS. However, in this case, goodwill attributable to NCI is included in the recoverable amount of the related CGU or group of CGUs.

Hence, while conducting impairment testing of goodwill, in this case, the carrying amount of goodwill allocated to such a CGU or group of CGUs is grossed up to include the unrecognised goodwill attributable to the NCI. This adjusted carrying amount is then compared with the recoverable amount of the unit to determine whether the CGU is impaired. This gross-up is not required if NCI were initially measured at fair value.

If a non-wholly owned CGU is impaired, then impairment losses are allocated between the amount attributable to the parent and to the NCI. Ind AS 36 requires an entity to allocate the impairment loss on the same basis as profit or loss is allocated to the parent and the NCI. If an impairment loss attributable to a NCI relates to goodwill that is not recognised in the parent’s CFS, that impairment is not recognised as a goodwill impairment loss. In such cases, only the impairment loss relating to the goodwill that is allocated to the parent is recognised as a goodwill impairment loss.

Presentation in the financial statements

In the parent’s CFS, as mentioned above, NCI are presented within equity, separately from the equity of the owners of the parent. Therefore, if there are NCI in more than one subsidiary, then those interests are presented in aggregate in the CFS. In the parent’s consolidated statement of profit and loss, the amount of profit or loss and total comprehensive income attributable to owners of the parent and NCI are shown separately; they are not presented as an item of income or expense.

The following illustration explains the disclosure

Extract of Statement of Profit and Loss for the year ended 31 March 2017

<table>
<thead>
<tr>
<th></th>
<th>Note</th>
<th>Year ended 31 March 2017</th>
<th>Year ended 31 March 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit attributable to owners of the company</td>
<td></td>
<td>5,848</td>
<td>3,738</td>
</tr>
<tr>
<td>NCI</td>
<td>19</td>
<td>376</td>
<td>219</td>
</tr>
<tr>
<td>Profit for the year</td>
<td></td>
<td>6,224</td>
<td>3,967</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Note</th>
<th>Year ended 31 March 2017</th>
<th>Year ended 31 March 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Other comprehensive income attributable to owners of the company</td>
<td></td>
<td>597</td>
<td>553</td>
</tr>
<tr>
<td>NCI</td>
<td>19</td>
<td>27</td>
<td>22</td>
</tr>
<tr>
<td>Other comprehensive income for the year</td>
<td></td>
<td>624</td>
<td>576</td>
</tr>
</tbody>
</table>
## Disclosure requirements

**Ind AS 112, Disclosure of Interests in Other Entities** requires that an entity should disclose information that enables users of its CFS to understand:

- The composition of the group, and
- The interest that NCIs have in the group’s activities and cash flows.

Therefore, following disclosures should be given:

### Each material subsidiary with NCI:

The disclosure should include for each of its subsidiaries that have NCIs that are material to the reporting entity. These disclosures should enable users of the CFS to understand the interests that NCIs have in the group’s activities and cash flows. Materiality assessment is important when identifying subsidiaries that NCI that are material to the reporting entity. A reporting entity would provide:

- The name of the subsidiary
- The principal place of business (and country of incorporation if different from the principal place of business) of the subsidiary
- The proportion of ownership interests held by the NCI
- The proportion of voting interests held by NCI, if different from the proportion of ownership interests held
- The profit or loss allocated to NCI of the subsidiary during the reporting period
- Dividends paid to NCI
- Accumulated NCI of the subsidiary at the end of the reporting period.

### Summarised financial information about subsidiaries:

For each subsidiary that has NCI that are material to the reporting entity, summarised financial information about the assets, liabilities, profit or loss and cash flows of the subsidiary that enables users to understand the interest that NCI have in the group’s activities and cash flows has to be provided. That information may include but would not be limited to, for example, current assets, non-current assets, current liabilities, non-current liabilities, revenue, profit or loss and total comprehensive income. This summarised financial information should be the amounts before inter-company eliminations.

### Significant restrictions:

An entity is required to disclose the nature and extent of any significant contractual or statutory restrictions on an entity’s ability to access or use the assets and settle the liabilities of the group such as:

- Restrictions on the ability of a parent or its subsidiaries to transfer cash or other assets to (or from) other entities within the group
- Guarantees or other requirements that may restrict dividends and other capital distributions being paid, or loans and advances being made or repaid, to (or from) other entities within the group
- Nature and extent of protective rights of NCI that can significantly restrict the entity’s ability to access or use the assets and settle the liabilities of the group e.g.
  - Parent obliged to settle liabilities of a subsidiary before settling its own liabilities, or
  - Approval of NCI is required either to access the assets or to settle the liabilities of a subsidiary. In particular related to transfer of cash and dividends or other capital distributions (e.g. in case of capital and/or foreign exchange controls or other regulatory limitations).

Additionally, an entity would need to disclose the carrying amounts in the CFS of the assets and liabilities to which above restrictions apply.

### Statement of cash flows:

In relation to above mentioned disclosure requirement, Ind AS 7, Statement of Cash Flows specifically requires disclosure to include, together with the commentary of management, the amount of significant cash and cash equivalent balances held by the entity that are not available for use by the group.

---

**Total comprehensive income attributable to owners of the company**

<table>
<thead>
<tr>
<th>Note</th>
<th>Year ended 31 March 2017</th>
<th>Year ended 31 March 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>6,445</td>
<td>4,291</td>
</tr>
<tr>
<td>NCI</td>
<td>19</td>
<td>403</td>
</tr>
<tr>
<td></td>
<td>6,848</td>
<td>4,532</td>
</tr>
</tbody>
</table>

(Source: KPMG in India’s publication: Illustrative Ind AS consolidated financial statements – First-time adoption, March 2017 edition)
• Disclosure of significant judgements: Ind AS 112 does not clarify whether the NCI disclosures should be given at the subsidiary level or at a subgroup level for the subgroup of the subsidiary. The IFRS Interpretations Committee clarified that in the context of the disclosure objective of Ind AS 112, materiality should be assessed by the reporting entity on the basis of the CFS of the reporting entity. In this assessment, a reporting entity would consider both quantitative considerations (i.e. the size of the subsidiary) and qualitative considerations (i.e. the nature of the subsidiary). The approach chosen by the reporting entity should best meet the disclosure objective of the Ind AS 112 in the circumstances. The IFRS Interpretations Committee observed that this judgement would be made separately for each subsidiary or subgroup that has a material NCI.

Key Ind AS 101 requirements

Ind AS 101, First-time Adoption of Indian Accounting Standards allows a first-time adopter to choose to not to apply Ind AS 103 retrospectively to past business combinations i.e. those transactions which occurred before the date of transition to Ind AS. Additionally, it has been provided that if an entity opts to restate any business combination to comply with Ind AS 103, then such entity should restate all business combinations later than the date of such business combination.

Therefore, Ind AS 101 provides following options for business combinations that occurred before the date of transition:

• Restate all business combinations that occurred after a particular date of the first-time adopter’s choice but before the date of transition or
• Do not restate any business combinations prior to the date of transition.

The exemption for past business combinations also applies to past acquisitions of investments in associates, interests in joint ventures and interests in joint operations in which the activity of the joint operation constitutes a business. Furthermore, the date selected to restate previous business combination applies equally for all such acquisitions.

If a first-time adopter opts to avail the business combination exemption then in such a case the balance of NCI under AS is not changed other than for adjustments made as part of the transition to Ind AS.

With respect to the business combinations that are not restated, a first-time adopter should apply the following requirements of Ind AS 110, in relation to accounting for NCI, prospectively from the date of transition to Ind AS:

a. An entity should attribute the profit or loss and each component of the OCI to the owners of the parent and to the NCI, even if this results in the NCI having a deficit balance.

b. When the proportion of the equity held by owners of the parent and NCI changes (without loss of control), an entity should adjust the carrying amounts of the owners of the parent and NCI to reflect the changes in their relative interests in the subsidiary. Such transactions would be recognised directly in equity (i.e. difference between the amount by which the NCI is adjusted and the fair value of the consideration paid or received, and attribute it to the owners of the parent).

c. When there is loss of control over a subsidiary, account for it in accordance with Ind AS and related requirements of Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations.

Additionally, if a subsidiary is being consolidated for the first time, then NCI are recognised as part of the initial consolidation adjustment.

On the other hand, if a first-time adopter elects to restate past business combinations in accordance with Ind AS, then the balance of NCI related to all such restated business combinations would be determined retrospectively, taking into account the impact of other elections made as part of the adoption of Ind AS.

NCI holding put options

Sometimes NCI of an entity’s subsidiary are granted put options that convey to those shareholders the right to sell their shares in that subsidiary for an exercise price (fixed or variable) specified in the option agreement. In the CFS, the put option written by the entity represents the group’s obligation to acquire one class of its own non-derivative equity instruments (shares in subsidiary) by delivering either cash, or a variable number of a different class of its own equity instruments (shares in parent).

In the absence of direct guidance in Ind AS 32, Financial Instruments: Presentation or 109, Financial Instruments, we consider that parent may elect an accounting policy based on either of the approaches provided in subsequent section.

© 2017 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.

2. IFRIC Update, September 2014, IFRS IC Foundation
Approach 1 – Put option recognised separately as a derivative liability

The shares issued by the subsidiary to NCI holders are considered as equity instruments, being ownership interests in the consolidated group and the put option is recognised separately. We consider that the entity may elect to apply one of the following two accounting policies for measurement of the put option liability:

- **Recognise a financial liability for the present value of the exercise price of the put option:**
  In accordance with Ind AS 32, the put option represents a contractual obligation for the entity to purchase its own equity instruments for cash/another financial asset. Therefore, the entity should recognise the present value of the amount payable on exercise of the option as a financial liability.

  The IFRS Interpretations Committee has considered the issue of recognition of change in the carrying amount of such a put liability and indicated that under IFRS, companies could elect to present such changes either in profit or loss or in equity. If the same interpretation were applied under Ind AS, then the entity could elect and consistently adopt an accounting policy for recognising the change in the present value of the amount payable on exercise of the put option, on each reporting date, either in profit or loss or equity.

  In accordance with the principles of Ind AS 110, the other impact of this transaction may be recognised on the basis of the NCI’s present access to the returns associated with the underlying shares (participation in fair value changes and rights to receive dividends). Thus, the NCI holders would continue to receive dividends on the shares held in subsidiary until the exercise of the put option. However, the option is exercisable at a fixed price that is adjusted for any dividends previously paid and the NCI holders cannot participate in the subsequent fair value changes in their shares. This indicates that the NCI does not have present access to all returns associated with an ownership interest in the shares. Therefore, the other impact of the put option transaction should be recognised as a debit to NCI (anticipated acquisition method) in the CFS.

- **Recognise put options as derivative liabilities at FVTPL**:  
  If the entity elects to apply this accounting policy, it is required to account for put options separately as derivative liabilities measured at their FVTPL in the CFS. On initial recognition of the derivative liability, the entity should also evaluate an appropriate accounting treatment for the corresponding impact. For example, one alternative could be to debit equity since this represents a cost of its investment in subsidiary. The equity shares held by NCI would continue to be classified and presented as equity instruments. Subsequent changes in the fair value of the derivative liability should be recognised in profit or loss.

Approach 2 – Classify shares held by NCI together with the put option as financial liabilities

Under this approach, the entity may apply the guidance in Ind AS 32 by considering all the contractual terms and conditions between the group and the NCI holders. This would require analysing the shares in subsidiary held by NCI together with the put option written by parent in favour of NCI. On a combined analysis of these instruments, the substance of the contractual terms states that there is a contractual obligation for the parent entity to deliver cash or a variable number of shares to the NCI holder at a future date, in exchange for the shares held in the subsidiary. Therefore, the shares held by NCI, together with the put option, effectively meet the definition of a financial liability and are recognised as such in the CFS.

**Conclusion**

The concept of NCI under Ind AS has many new requirements. The article highlights some of the new concepts related to NCI accounting. The entities transitioning to Ind AS should consider the facts and circumstances of the transactions and the economic environment to deliberate the effect of new accounting requirements.
Consider this

- Currently, minority interest arising on consolidation is measured at proportionate share in the book values of the net assets of the subsidiary. Under Ind AS, minority interest (referred to as NCI) needs to be measured on the acquisition date at either their fair value or based on the proportionate share of the fair value of the acquired entity’s identifiable net assets. This choice can be applied on a case by case basis.

- Ind AS 110 requires losses relating to subsidiaries to be attributed to NCI even if it results in a negative balance. Therefore, in such a case, NCI could be a debit balance.

- The NCI in the balance sheet is classified as equity but are presented separately from the parent shareholders’ equity.

- Profit or loss and Other Comprehensive Income (OCI) for the period are allocated between NCI and the shareholders of the parent.

- An entity may write a put option in favour of NCI holders in an existing subsidiary which is exercisable only on the occurrence of uncertain future events that are outside the control of both parties to the contract. In this case, the entity should account for the put option only if the terms affecting the exercisability of the option are genuine.
Introduction

Under the Companies Act, 2013 (2013 Act), depreciation accounting assumes a new order, from a regime of prescription based depreciation rates, the new law now provides only indicative rates and requires management to exercise judgement in arriving at rates for depreciation based on the expected usage pattern of assets.

Section 123 of the 2013 Act requires that a company declares or pays dividends out of the profits of the company for that year which is arrived at after providing for depreciation in accordance with Schedule II of the 2013 Act (Schedule II). Similarly, for payment of managerial remuneration to the Directors, net profits are to be computed after deducting the amount of depreciation calculated in accordance with Section 123 of the 2013 Act.

Therefore, Section 123 and Schedule II lay down the requirements for depreciation under the 2013 Act.

To help understand the requirements of the Schedule II, the Institute of Chartered Accountants of India (ICAI) has issued an application guide (Application Guide on Provisions of Schedule II to the 2013 Act) and a guidance note (Guidance Note on Accounting for Depreciation in Companies in the context of Schedule II to the 2013 Act) in the past. Additionally, the ICAI has recently issued an educational material on the Ind AS 16, Property, Plant and Equipment which provides the key requirements of the standard and the Frequently Asked Questions (FAQs) covering the issues which are expected to be encountered frequently while implementing the standard.

It is important to note that with the revised Accounting Standard (AS) 10, Property, Plant and Equipment and withdrawal of AS 6, Depreciation Accounting, the requirements of AS and Indian Accounting Standards (Ind AS) are largely similar now.

This article summarises the provisions governing depreciation under Schedule II and how they differ from the provisions of the erstwhile Schedule XIV. Additionally, it also highlights the related key guidance/clarifications comprised in the application guide and guidance note issued by the ICAI.
Key provisions of the Schedule II

Following is an overview of the key provisions for accounting of depreciation as provided under the Schedule II:

**Useful life and residual value of assets**

Schedule II defines depreciation as the systematic allocation of the depreciable amount of an asset over its useful life. The definition contains two significant terms – depreciable amount and useful life. These terms have been defined as follows:

a. **Depreciable amount** of an asset is the cost of an asset or other amounts substituted for cost, less its residual value.

b. **Useful life of an asset** is the period over which an asset is expected to be available for use by an entity, or the number of production or similar units expected to be obtained from the asset by the entity.

Therefore, it means that the companies are required to depreciate assets over their useful life after considering the residual value.

Schedule XIV of the Companies Act, 1956 was prescriptive in nature as it specified the minimum rates of depreciation to be applied under Straight Line Method (SLM) or Written Down Value (WDV) method for different class of assets. Schedule II, on the other hand provides indicative useful lives for various tangible assets and states that the residual value of an asset should not be more than five per cent of the original cost of the asset.

The guidance note and the application guide clarified that the useful life and residual value of assets (contained in Schedule II) are indicative in nature. Therefore, companies may determine different useful life and residual value of the assets which could be higher or lower than those specified in the Schedule II. However, in case a company uses a different useful life (higher or lower than specified in Schedule II) or a residual value of more than five percent, the financial statements of the company should disclose such difference and provide justification duly supported by a technical advice.

Moreover, both AS 10 and Ind AS 16, *Property, Plant and Equipment* require that the residual value and the useful life of an asset should be reviewed at least at each financial year end and, if expectations differ from previous estimates, the change(s) should be accounted for as a change in an accounting estimate. Additionally, the Ind AS Transition Facilitation Group (ITFG) in its Bulletin 11 also clarified that selection of the method of depreciation (e.g. SLM or WDV) is an accounting estimate, and not selection of an accounting policy. **Useful life or residual value governed by other regulatory authority**

Part B of the Schedule II explicitly states that the useful life or residual value of any specific asset as notified for accounting purposes by a regulatory authority constituted under an Act of Parliament or by the Central Government should be applied in calculating the depreciation to be provided for such asset irrespective of the requirements of the Schedule II.

Such a provision was not present in the Schedule XIV, except for the companies engaged in the generation/supply of electricity wherein it had been specifically clarified that the depreciation charged under the Electricity Act, 2003 would prevail over the Schedule XIV for such companies.

**Component accounting mandatory**

Useful life prescribed under Schedule II is for whole of the asset. However, where cost of part of the asset is significant to total cost of the asset and useful life of that part is different from the useful life of the remaining asset, useful life of significant part should be determined separately. Such an approach is known as ‘component accounting’ which is mandatory under the 2013 Act and requires companies to identify and depreciate significant components with different useful lives separately.

The application of component accounting could pose significant challenge for the companies in terms of identification of significant components of an asset and determining the cost of such components. The guidance note and the application guide provide detailed guidance in these areas.

**Identification of significant components**

Identification of significant components requires a careful assessment of facts and circumstances. Such an assessment would include at a minimum:

- Comparison of the cost allocated to the item to the total cost of the aggregated Property, Plant and Equipment (PPE) and
- Consideration of potential impact of componentisation on the depreciation expense.

As a company is required to identify only material/significant components separately for the purpose of charging depreciation, materiality is a matter of judgement that need to be decided on the facts of each case. The guidance note gives indicators to assess significant components:

- Determine the threshold value to determine which asset requires componentisation.
- Threshold value in percentage of cost of component to the total cost of the asset
- Proportion of useful life of that part as compared to the useful life of the asset
- Potential impact on the total depreciation expenditure.

---

1. ITFG Clarification Bulletin 11 dated 1 August 2017 issued by the ICAI.
2. General circular dated 31 May 2011 issued by the Ministry of Corporate Affairs (MCA).
Companies also need to consider impact on retained earnings, current year profit or loss and future profit or loss (i.e. when the part would be replaced) in order to decide materiality. The application guide mentions that companies may consider 10 per cent of original cost of the asset as a threshold to determine whether a component is material/significant.

**Determination of cost of significant components**

With respect to determination of the cost of such parts, the application guide and the guidance note prescribe following criteria which can be used by the companies for determining the cost of such parts:

a. Break-up cost provided by the vendor
b. Cost break-up given by internal/ external technical expert
c. Fair values of various components or
d. Current replacement cost of component of the related asset and applying the same basis on the historical cost of asset.

**Depreciation of significant components**

Every significant component which has a useful life different from the remaining asset should be depreciated separately. Therefore, two situations could arise and they are as follows:

- **Useful life of the component is lower than the useful life of the principal asset as per Schedule II:** Such lower life should be used for computing depreciation for the component.
- **Useful life of the component is higher than the useful life of the principal asset as per Schedule II:** Though a company has a choice of using either the higher or the lower useful life, use of higher life is permitted only when the management of the company intends to use the component even after the expiry of the useful life of the principal asset.

In practice, an issue may arise in case of companies that are depreciating their PPE based on prescribed regulatory rates. In such cases, whether such companies could identify components and depreciate them using a different rate remains as a moot point.

**Amortisation of intangible assets**

Depreciation also includes amortisation of intangibles as per Schedule II. Schedule II specifically mentions that intangible assets will be amortised as per Ind AS for companies following Ind AS.

Accordingly, Ind AS 38, *Intangible Assets* specifies that the accounting for an intangible asset is based on its useful life. An intangible asset with a finite useful life is to be amortised, however, an intangible asset with an indefinite useful life is not amortised.

Amortisation for an intangible with finite useful life should begin when the asset is available for use, i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Amortisation should cease at the earlier of the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with Ind AS 105, *Non-current Assets Held for Sale and Discontinued Operations* and the date that the asset is derecognised.

Additionally, the amortisation method used should reflect the pattern in which the asset’s future economic benefits are expected to be consumed by the entity. If that pattern cannot be determined reliably, then the straight-line method should be used.

On 31 March 2014, the Ministry of Corporate Affairs (MCA) amended the provisions relating to determination of useful lives of intangible assets prescribed in Schedule II. The amendment permitted companies to apply revenue-based amortisation, based on the proportion of actual revenue for the year as compared to the total projected revenue from the intangible asset during the concession period for ‘toll road’ intangible assets.

However, Ind AS 38, specifies that an amortisation method based on revenue generated by an activity that includes the use of an intangible asset is presumed to be inappropriate, except in very limited circumstances.

In order to transition to Ind AS, Ind AS 101, *First-time Adoption of Indian Accounting Standards* permits companies to apply a previously used amortisation method for such toll-road intangibles only to assets existing at the beginning of the first year of adoption of Ind AS.

This represented an inconsistency between the guidance in Schedule II and in Ind AS.

Accordingly, MCA recently amended Schedule II replacing a part of the provision relating to intangible assets and provides the following:

- **Companies following Ind AS:**
  Companies following Ind AS would be unable to apply revenue-based amortisation method to toll road related intangible assets that are recognised after the beginning of the first year of adoption of Ind AS.
Companies following AS:

Companies that continue to follow AS are permitted to continue applying the exception in Schedule II and use a revenue-based amortisation method for their toll road intangibles.

Continuous Process Plant (CPP)\(^5\) and multiple shift depreciation

With useful life and component approach guidance, the provisions relating to CPP and multiple shift depreciation have been realigned accordingly.

CPP

CPP means a plant which is required and designed to operate for 24-hours a day. The guidance note specifically requires that the term used in the definition ‘required and designed to operate for 24-hours a day’ should be interpreted with reference to the inherent technical nature of the plant, i.e., the technical design of a CPP should be such that there is a requirement to run it continuously for 24-hours a day. Such a plant could be shut down for some time (for instance due to lack of demand, maintenance etc.), however such a shut down does not change the inherent technical nature of the plant. It would still be considered as a CPP and useful life as estimated would be applicable for providing depreciation.

Additionally, it is to be noted that a CPP is distinct from the repetitive process plant or assembly-line type plants. These plants are not CPP since such plants do not involve significant shut-down and/or start-up costs and are not technically required and designed to operate 24-hours a day, for example, an automobile manufacturing plant. Therefore, determination of whether a PPE is a CPP could be subjective and may require technical evaluation.

Schedule II indicates useful life, of CPP, for example, 25 years for ‘CPP, other than those for which special rates’ has been prescribed in the Schedule II and certain special rates for others.

The Guidance note and the application guide reiterates that the principle of estimation of useful life and concept of component accounting are also applicable to a CPP.

On the other hand, Schedule XIV, inter alia, specified the general rates of 15.28 per cent under WDV method and 5.33 per cent under the Straight Line Method (SLM) of depreciation for ‘CPP, other than those for which special rates’ had been prescribed.

It is important to note that what has been considered as CPP under the Schedule II is the same as it was under Schedule XIV i.e. a plant which was not a CPP under Schedule XIV could not be a CPP under Schedule II.

Multiple shift depreciation

The useful lives of assets specified under Schedule II are based on their single shift working. However, where a company estimated the useful life of an asset on a single shift basis at the beginning of the year but uses the asset on double or triple shift during the year, then the depreciation expense would increase by 50 or 100 per cent as the case may be for that period.

The guidance note requires that the company should determine whether the use of an asset for an extra shift was on sporadic basis in the past and would continue in future also. If the use is on a sporadic basis, then the depreciation expense for the double or triple shift should be increased by 50 per cent or 100 per cent as the case may be for the period of use.

However, if the company estimates that the use of the asset for extra shift would not be on a sporadic basis i.e. the extra shift working for the asset would be on regular or continuous basis, it should reassess its useful life considering its use on extra shift basis. Hence, the reassessed useful life should then be used for the purpose of charging depreciation expense.

Schedule XIV specified substantially different requirements of depreciation. It specified separate rates of depreciation for single, double and triple shift use of assets. Both under Schedule XIV and Schedule II, extra shift depreciation is applicable only for the actual number of days for which the asset has been operated on double/triple shift basis.

Further, it should be noted that in case the useful life has been estimated on double/triple shift basis at the beginning of the year, the concept of extra shift depreciation will not apply. In such an instance, the company will need to evaluate whether there is any change in the circumstances on which the useful life of asset was based or any new developments have taken place which may have impact on the estimated useful life of the asset. If there is any such indication, the company should reassess the remaining useful life of the assets on the basis of the changed circumstances/new developments. For instance, use of the asset on a single shift basis in future.

Depreciation on low value items

Schedule XIV included specific provision for depreciable assets at the rate of 100 per cent whose actual cost did not exceed INR5,000. This provision was based on the practices followed by the companies based on the materiality of the financial impact of such charge.

\(^5\) CPP means a plant which is required and designed to operate for 24-hours a day.
However, since the life of an asset is a matter of estimation, therefore, Schedule II does not prescribe such a bright line. A company could have a policy to fully depreciate assets up to certain threshold limits considering materiality aspect in the year of acquisition. The materiality of such a charge should be considered with reference to the cost of the asset and the size of the company.

Similar issue has been considered and clarified in the educational material on Ind AS 16 and it states that determination of an individual item as insignificant and not considering the same as PPE is a matter of professional judgement which requires careful assessment of facts and circumstances including qualitative aspects. Accordingly, individual insignificant assets below a certain threshold determined by the management may not be recognised as PPE. These may be expensed if their cumulative aggregate cost for that category of asset is not material.

**Disclosures**

In case of deviation from the indicative useful life and/or residual value prescribed in Schedule II, companies are required to disclose useful life and/or residual value of assets adopted along with the fact that the adopted useful lives and residual values are duly supported by a technical advice.

Keeping in view the estimations and assumptions involved around determination of useful lives/residual value, disclosure requirements prescribed under Schedule II definitely aim to promote best practices and transparency.

---

**Consider this**

- Although the provisions of Schedule II offer flexibility to the companies i.e. it allows companies to follow different useful life/residual value, the management will have to technically evaluate and make use of judgement for determination of useful life and identification of significant parts.

- Accounting of depreciation has an impact on the distributable profits and calculation of managerial remuneration.

- Useful life, depreciation method and residual values of the PPE are considered as accounting estimates.
Application of Ind AS would allow goodwill recognition only when there is a business combination. Such a goodwill would be an asset that represents the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised.

Under Accounting Standards (AS), goodwill would arise by application of erstwhile AS 10, Accounting for Fixed Assets consequent to an asset purchase, AS 14, Accounting for Amalgamations in respect of mergers and AS 21, Consolidated Financial Statements by virtue of equity interests of the reporting entity in other entities.

Goodwill does not generate cash flows independently of other assets or groups of assets and often contributes to the cash flows of multiple cash-generating units. Therefore, goodwill can never be a Cash Generating Unit (CGU) on its own.

An entity must ensure that its assets are carried at no more than their recoverable amount. According to Ind AS 36, Impairment of Assets when an asset is carried at more than its recoverable amount i.e. its carrying amount exceeds the amount to be recovered through use or sale of the asset, then in this case, the asset is described as impaired and an entity has to recognise an impairment loss.

Once an entity recognises goodwill arising from a business combination, Ind AS prescribes specific requirements about how goodwill is tested for impairment as part of the testing of CGUs.

**Background to impairment testing**

A CGU is the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups thereof.

In testing for impairment, the carrying amount of an asset or CGU is compared with its ‘recoverable amount’, which is the higher of:

- the asset’s or CGU’s fair value less costs of disposal; and
- value in use.

‘Fair Value Less Costs of Disposal’ (FVLCD) is the price that would be received to sell an asset or CGU in an orderly transaction between market participants at the measurement date, less the costs of disposal.
Key considerations

In this article, we aim to elaborate on the important considerations that the entities following Ind AS should lay emphasis while conducting and presenting impairment test of goodwill.

Value in use’ is the present value of the future cash flows expected to be derived from an asset or CGU. Value in use is a valuation concept that is specific to Ind AS 36 and not used in other Ind AS. It combines entity-specific estimates of future cash flows - from continuing use and eventual disposal of the asset or CGU - with a market participant-based discount rate. Ind AS 36 includes detailed rule-based requirements on determining value in use.

1. A CGU or a group of CGUs to which goodwill has been allocated is being tested for impairment when there is an indication of possible impairment, or

2. Goodwill is being tested for impairment in the annual mandatory impairment testing, without there being an indication of impairment in the underlying CGUs.

Method of impairment assessment

There are two scenarios in which goodwill is tested for impairment:

Frequency of goodwill impairment

Under Ind AS, CGUs to which goodwill has been allocated are required to be tested for impairment annually. In addition, impairment tests could be performed by the entity as a result of a triggering event.

While under Accounting Standards, goodwill is tested for impairment only when there is a triggering event indicating impairment.

Under Ind AS goodwill is no longer amortised but tested for impairment.

Basis of allocation of goodwill to CGUs

As mentioned above, goodwill does not generate independent cash inflows; therefore, the asset needs to be allocated to a CGU or a group of CGUs. Therefore, goodwill arising in a business combination is allocated to the acquirer’s CGUs that are expected to benefit from the synergies of the business combination in which goodwill arose. This is irrespective of whether other assets or liabilities of the acquiree are assigned to those units.

Ind AS 36 does not prescribe any specific method of identifying synergies or of allocating goodwill and that valuation specialists could be used for this purpose. The pre-acquisition analysis of the acquirer may be useful in allocating the goodwill to CGUs. This analysis may indicate the drivers behind the synergies that are expected to arise from the acquisition and may help in finding an appropriate method for allocating the goodwill between CGUs. Examples of methods of allocation include the with or without method, allocation in proportion to the relative fair value of the identifiable net assets in each CGU and allocation in proportion to the relative fair values of the CGUs.

Measurement of impairment loss and interaction with Ind AS 108, Operating Segments

Goodwill sometimes cannot be allocated on a non-arbitrary basis to an individual CGU but only to groups of CGUs. Therefore, each unit or group of units to which goodwill is allocated:

• Should represent the lowest level within the entity for which information about goodwill is available and monitored for internal management purposes, and

• Should not be larger than an operating segment, determined in accordance with Ind AS 108 before applying the aggregation criteria of Ind AS 108.

Goodwill is allocated to the lowest level at which it is monitored for internal management purposes. This is to avoid the need to develop additional reporting systems to support goodwill impairment testing. However, this does not mean that entities can avoid testing goodwill at a level lower than an operating segment by simply not monitoring goodwill explicitly.

Under Accounting Standards, the reporting entities in India that have a matrix organisation could have used the management approach to define CGUs for the purpose of monitoring goodwill without taking the segments into consideration. Under Ind AS, reporting entities would need to consider the allocation of goodwill to CGUs while considering the interaction with Ind AS 108.

© 2017 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.
**Cash flow projections**

In measuring value in use, cash flow projections should be based on reasonable and supportable assumptions that represent management’s best estimate of the range of future economic conditions. Ind AS lays greater weight to external evidence with which management determines its best estimate of cash flow projections. Management should also assess the reasonableness of the assumptions on which cash flow projections are based by examining the causes of differences between past cash flow projections and actual cash flows and ensure consistency of the current cash flow projections with past actual outcomes, provided the effects of subsequent events or circumstances that did not exist when those actual cash flows were generated make this appropriate.

Detailed, explicit and reliable financial budgets/forecasts of future cash flows for periods longer than five years are generally not available. For this reason, management’s estimates of future cash flows are based on the most recent budgets/forecasts for a maximum of five years. Management may use cash flow projections based on financial budgets/forecasts over a period longer than five years if it is confident that these projections are reliable and it can demonstrate its ability, based on past experience, to forecast cash flows accurately over that longer period.

Ind AS 36 provides a detailed guidance on developing cash flow projections, including the treatment of future cost, capital expenditures, restructuring, etc.

**Use of discount factor**

As part of the impairment process, Ind AS 36 requires that future cash flows are estimated in the currency in which they will be generated and then discounted using a discount rate appropriate for that currency.

In determining value in use, projected future cash flows are discounted using a pre-tax discount rate that reflects:

- current market assessments of the time value of money; and
- the risks specific to the asset or CGU.

The discount rate is based on the return that investors would require if they were to choose an investment that would generate cash flows of amounts, timing and risk profile equivalent to those of the asset or CGU. In other words, the discount rate is based on a market participant’s view of the asset or CGU as at the current date. Therefore, although the cash flows in the value in use calculation are entity-specific, the discount rate is not.

In our experience, it is rare that a discount rate can be observed directly from the market. Therefore, an entity will generally need to build up a market participant discount rate that appropriately reflects the risks associated with the cash flows of the CGU being valued. In the absence of a discount rate that can be observed directly from the market, Ind AS 36 refers to other starting points in determining an appropriate discount rate:

- the entity’s Weighted-Average Cost of Capital (WACC)
- the entity’s incremental borrowing rate, and
- other market borrowing rates.

**Key assumptions**

While performing impairment analysis, there is a need to use assumptions that represent realistic future expectations. Ind AS 36 requires detailed disclosures on estimates used to measure the recoverable amount of CGU to which significant goodwill is allocated.

**Value in use**

When a CGU’s recoverable amount is based on its value in use, considerable judgement has to be exercised by the management. Therefore, entities would need to provide sufficient CGU-specific qualitative and quantitative disclosures. The aim of Ind AS 36 is help users understand the approach followed by the management.

For value in use, Ind AS 36 requires management to explain its approach in determining the values assigned to each key assumption by allowing users to understand whether these values are consistent with external sources of information or how and why they differ from past experience or external sources of information.

Additionally, an entity would need to provide following disclosures:

- Each key assumption on which management has based its cash flow projections for the period covered by the most recent budgets/forecasts.
- Key assumptions are those to which the unit’s (group of units) recoverable amount is most sensitive.
- The period over which management has projected cash flows based on financial budgets/forecasts approved by management and, when a period greater than five years is used for a cash-generating unit (group of units), an explanation of why that longer period is justified.
- The growth rate used to extrapolate cash flow projections beyond the period covered by the most recent budgets/forecasts, and the justification for using any growth rate that exceeds the long-term average growth rate for the products, industries, or country or countries in which the entity operates, or for the market to which the unit (group of units) is dedicated.
The discount rate(s) applied to the cash flow projections.

Fair Value Less Costs of Disposal (FVLCD)

When a CGU’s recoverable amount is based on its FVLCD, again considerable judgement has to be exercised by the management while applying valuation techniques. If FVLCD is not measured using a quoted price for an identical unit (group of units), an entity should disclose the following information:

- Each key assumption on which the management has based its determination of FVLCD. Key assumptions are those to which the unit’s (group of units) recoverable amount is most sensitive.
- A description of management’s approach to determining the value (or values) assigned to each key assumption, whether those values reflect past experience or, if appropriate, are consistent with external sources of information, and, if not, how and why they differ from past experience or external sources of information.
- The level of the fair value hierarchy (see Ind AS 113 within which the fair value measurement is categorised in its entirety (without giving regard to the observability of ‘costs of disposal’)).
- If there has been a change in valuation technique, the change and the reason(s) for making it.

If FVLCD is measured using discounted cash flow projections, an entity should disclose the following information:

- the period over which management has projected cash flows
- the growth rate used to extrapolate cash flow projections
- the discount rate(s) applied to the cash flow projections.

Sensitivity analysis

Ind AS 36 calls for disclosures aimed at helping users in assessing the safety margin and evaluating how sensitive the assessment is to a change in one or several of key assumptions used when determining the recoverable amount. Therefore, entities would need to consider the current economic environment and make these disclosures relevant and include assumptions such the growth rates, the discount rate, the operating margin and their impact on revenues or volume of sales. Additionally, Ind AS 1, Presentation of Financial Statements requires similar disclosures on assumptions made about the future, and other major sources of estimation uncertainty, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets within the next financial year.

In our experience, the disclosures related to goodwill are the most challenging, requiring information about key assumptions made in estimating recoverable amount and a sensitivity analysis dealing with key assumptions that might reasonably change and thereby trigger an impairment loss. Additionally, the entities should check the consistency and reasonableness of the inputs used in various valuation techniques e.g. Ind AS 36, Impairment of Assets, Ind AS 37, Provisions, Contingent Assets and Contingent Assets, IAS 19, Employee benefits, etc. while presenting and disclosing financial statements.

Consider this

- Estimates of future cash flows in the value in use calculation are specific to the entity, and need not be the same as those of market participants. The discount rate used in the value in use calculation reflects the market’s assessment of the risks specific to the asset or CGU, as well as the time value of money.
- An impairment loss for a CGU is allocated first to any goodwill and then pro rata to other assets in the CGU that are in the scope of Ind AS 36.
- An impairment loss is generally recognised in profit or loss.
- Reversals of impairment of goodwill are prohibited.
The Institute of Chartered Accountants of India (ICAI), on 14 August 2017, issued educational material on Ind AS 16, which summarises the key requirements in Ind AS 16 and accounting issues that are expected to arise while implementing Ind AS 16 in the form of Frequently Asked Questions (FAQs). Key clarifications provided in the FAQs on significant implementation issues are as follows:

**Recognition**

- **Assets not considered to be material:** Ind AS 16 does not prescribe the unit of measure for recognition of assets, and entities need to exercise judgement when applying the recognition criteria to Property, Plant and Equipment (PPE). Accordingly, ICAI clarified that entities should determine whether an individual item is insignificant and may not be recognised as PPE based on a careful assessment of facts and circumstances including consideration of materiality. Consequently, individual assets below a certain threshold determined by management may not be recognised as PPE, or be fully depreciated in the year of acquisition, provided their cumulative aggregate cost for that category of asset is not material.

- **Capitalisation and depreciation of spares:** The ICAI clarified that machinery spares that are held for use in the production of goods and are expected to be used for more than one period meet the definition of PPE. Therefore, such spares should be capitalised as PPE, irrespective of whether they have been procured at the time of purchase of the equipment or subsequently. However, where spares are not expected to be used for more than one annual period, although they may be used in two financial years, they would not meet the criteria for capitalisation as PPE.

- **Expenses incurred for aesthetic purposes:** Tangible items purchased for aesthetic purposes (such as paintings and sculptures at entrance hall and conference rooms), are considered to be held for administrative purposes. Items held for administrative purposes qualify as PPE as per the definition in Ind AS 16. If these items are expected to be used during more than one period, then they should be capitalised as PPE.

The ICAI further clarified that where an entity holds a rare piece of art or antique paintings that are protected by legal or contractual rights such as copyrights (e.g. signature of painter), it should evaluate whether such items are tangible or intangible assets. Where it is probable that the future economic benefits are expected to be derived from the intangible element, such items may be capitalised and disclosed as a separate class of intangible asset.
• **Assets with an intangible element:** Where an entity procures tangible assets with an intangible element (e.g., procurement of technical know-how for designing and installation of a plant), it should exercise judgement to determine which element of the asset is more significant - the PPE or the intangible element. Where the intangible element is integral to the larger asset, it should be capitalised as PPE as a directly attributable cost of acquisition or construction of the asset. However, if the intangible part is a separate asset in its own right, it should be capitalised as an intangible asset.

• **Consumables used in the process of manufacture:** The ICAI analysed the classification of process chemicals or consumables used in the process of manufacturing, e.g., catalysts used to manufacture chemicals. It clarified that the classification of catalysts used in the process of manufacturing, as PPE or inventory, would depend on whether they facilitate the process of manufacture or are consumed in the process. Accordingly, following situations summarise the accounting:
  - Catalyst facilitates the manufacturing process: If a catalyst with a life (or charge) of more than one year facilitates the manufacturing process, such that it can be reused, then it is considered to increase the future economic benefits and output efficiency of the plant. It would accordingly be capitalised as PPE.
  - Catalyst is consumed in the manufacturing process: If a catalyst with a life (or charge) of more than one year is in the nature of a supply to be consumed in the production process, it is considered as a consumable. It would accordingly be classified as an inventory.

**Initial measurement**

• **Expenditure incurred by an entity to obtain regulatory permission to set-up a factory:** The ICAI clarified that such expenses should be capitalised in the cost of the factory building if these are directly attributable to bringing the factory building to the location and condition necessary for use and if management considers it probable that the relevant permission will be granted. Else, these expenses should be charged to the statement of profit and loss and cannot be capitalised subsequently.

• **Expenses incurred for welfare of employees:** The ICAI considered a situation where an entity has incurred non-obligatory expenses to construct/develop a tangible asset, e.g., a school (over which it does not have ownership rights) close to its refinery. The school is available for use by its employees and the general public. The ICAI clarified that such expenditure would not be considered directly attributable to bringing the refinery to its working condition for its intended use. Therefore, the expense incurred on developing the school should not be capitalised as PPE.

• **Cancellation fees on contract:** Entities may pay penalties or cancellation fees for terminating a contract to procure PPE from one vendor, and instead procure it from another. The ICAI clarified that such penalties or cancellation fees are not directly attributable to bringing the asset to the location and condition necessary for it to be capable of operation in the manner intended by management. Hence, these costs should not be capitalised as PPE.

• **Acquisition of land with an existing building:** Ind AS 16 states that land and buildings are separable assets and are accounted for separately, even when they are acquired together. In this context, ICAI considered a scenario where an entity acquires land with an existing building, and intends to demolish the building after acquisition. The existing building would not be utilised for any of the entity’s business activities. The ICAI clarified that in this situation, the entity should capitalise the amount paid for the building in the cost of the land (irrespective of the fact that the fair values of land and building are available separately).

• **Interruption in construction of building:** The ICAI clarified that when construction of a building is interrupted due to abnormal delays, such as protests by farmers for additional compensation for an indefinite period, then costs incurred during the period of interruption should not be capitalised. This is because the interruption is not in nature of a temporary delay and not a necessary part of the process of bringing the asset to the location and condition necessary for its intended use.

• **Accounting for demurrage:** Demurrage generally represents an abnormal cost and hence, should not be included as an element of cost of PPE. The ICAI, therefore, clarified that demurrage incurred on account of a nationwide transporters strike, represented an abnormal cost, and should not be capitalised to determine the cost of imported PPE. However, incurrence of demurrage may sometimes represent a normal cost considering the specific facts and circumstances of the case.

• **Discounts and rebates on PPE:** Ind AS 16 requires trade discounts and rebates to be reduced from the cost of PPE. The ICAI has clarified that it does not matter whether such discounts or rebates are received from the vendor directly or indirectly through a broker. For example, commission passed on by a broker to induce an entity to purchase an item of PPE would be in the nature of trade discounts and rebates received by the entity, which is deducted from the cost of acquisition of the item.
Component accounting

Major periodic inspection and repairs: Certain items of PPE may be required to undergo major periodic inspections and repairs, e.g. ships need to undergo dry docking at an interval of three years as per statute. The cost of major inspections and replacements of parts should be recognised in the carrying amount of the PPE if the recognition criteria are satisfied. In the example above, the entity should account for the dry docking cost as below:

- **Cost of replacing parts:** If the costs of replacing parts meets the recognition criteria in Ind AS 16, the entity should capitalise those parts in the carrying amount of the ship as a separate component and derecognise the replaced parts. These parts will be depreciated over their useful life, i.e. three years.
- **Major inspection costs:** Major inspection costs should also be recognised in the carrying amount of the ship and be depreciated over the period remaining until the next dry-docking.

Revaluation

- **Revaluation on business combination:** Ind AS 103, Business Combinations requires an entity acquiring another entity to measure the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values. The ICAI clarified that the fair value measurement of assets acquired is just an initial recognition of the asset at cost by the acquirer and does not tantamount to adoption of a revaluation model for existing assets within the same class.
- **Revaluation of assets under finance lease:** The ICAI clarified that assets held under a finance lease and owned assets of similar nature and use should be classified as one class of assets and revaluation principles would apply to the entire class of assets.

Depreciation

- **Useful life of PPE:** The ICAI clarified that determination of useful life and residual value of PPE is a matter of judgement and may be decided on a case to case basis. If an entity has adequate internal technical expertise, it may be appropriate for it to rely on the judgement of internal experts. Such advice should be supported by adequate documentation including the criteria and assumptions involved in making the determination of useful lives and residual value.
- **Depreciation on spares:** Ind AS 16 states that depreciation of an asset begins when it is available for use, and does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated. Accordingly, the ICAI clarified that depreciation on spares recognised as PPE should begin from the date of their purchase.

Liquidated damages

- **Liquidated damages payable subsequent to commissioning of plant:** An entity may be entitled to receive liquidated damages for a construction contractor’s failure to meet performance conditions in terms of the desired quality and level of output subsequent to commissioning of a plant. The ICAI clarified that such liquidated damages arise as a result of inefficiencies on the part of the contractor and are directly linked to performance parameters for the plant subsequent to commissioning of the plant. Hence, these liquidated damages should not be deducted from the cost of the related PPE.
- **Liquidated damages for construction delays by contractor:** The treatment of liquidated damages received on delays in completion of construction by the contractor depends on the facts and circumstances:
  - Liquidated damages are directly identifiable with the project and mitigate extra project costs to be incurred by the entity would be capitalised as part of the cost of the asset.
  - Other liquidated damages should be recognised as income.

Enabling assets

- The ICAI clarified that the construction cost of enabling assets e.g. railway siding, road and bridge constructed by an entity to facilitate construction of a main plant (e.g. refinery), should be considered as the cost of construction of the refinery. Accordingly, expenditure incurred on enabling assets should be allocated and capitalised as part of the PPE. Though the entity cannot restrict the access of others from using the enabling assets, the reason for capitalisation of these items is that they are incurred in order to get future economic benefits from the project as a whole. Therefore, the project as a whole can be considered as the unit of measure for the purpose of capitalisation of the expenditure on enabling assets.
MCA issued clarification for payments banks and small finance banks to comply with the Ind AS Rules

The Ministry of Corporate Affairs (MCA) through its notification dated 16 February 2015 laid down the road map for implementation of Indian Accounting Standards (Ind AS) by companies other than banking companies, insurance companies and Non-Banking Financial Companies (corporate road map).

On 11 February 2016, the Reserve Bank of India (RBI) issued a circular (RBI/2015-16/315) which requires holding, subsidiary, joint venture or associate companies of scheduled commercial banks (excluding regional rural banks) to comply with Ind AS for accounting periods beginning from 1 April 2018 onwards, with comparatives for periods ending on or after 31 March 2018.

New development

The MCA through a circular (no. 10/2017) dated 13 September 2017 clarified that in case a holding company covered under the corporate road map of Ind AS has payments bank or small finance bank as its subsidiary, then the holding company should continue to follow the corporate road map. However, the payments bank or the small finance bank should follow the banking sector road map as prescribed by RBI.

Therefore, according to the clarification (in case of holding company covered under phase II of the corporate road map has a subsidiary as a payment bank or a small finance bank, then it would comply with the following timelines:

- **Holding company**: Follow Ind AS from 1 April 2017 with comparatives for the period ending on or after 31 March 2017
- **Payments bank or small finance bank (subsidiary company)**: Follow Ind AS from 1 April 2018 with comparatives for the period ending on or after 31 March 2018. However such a subsidiary would need to provide Ind AS financial data to its holding company for the period ending on or after 31 March 2018.

Please refer KPMG in India's IFRS Notes dated 18 September 2017 which provides an overview of the recent MCA notification.

(Source: MCA circular no. 10/2017 dated 13 September 2017)
MCA issued clarification in respect to appointment of an independent director

The MCA through its circular dated 5 July 2017 amended Rule 4 of the Companies (Appointment and Qualification of Directors) Rules and provided that an unlisted public company which is a joint venture, a wholly owned subsidiary or a dormant company will not be required to appoint Independent Directors.

However, the term ‘joint venture’ is not defined in the 2013 Act.

New development

The MCA clarified the meaning of the term ‘joint venture’ for the purposes of availing exemption under Rule 4 through its notification dated 5 September 2017. Accordingly, a joint venture would mean a joint arrangement, entered into in writing, whereby the parties that have joint control of the arrangement, have rights to the net assets of the arrangement.

(Source: MCA circular no. 9/2017 dated 5 September 2017)

IASB issued an exposure draft to clarify how to distinguish accounting policies from accounting estimates

Background

International Accounting Standard (IAS) 8, Accounting policies, Changes in Accounting Estimates and Errors contains different requirements on how to account for changes in accounting policies and for changes in accounting estimates. However, the IFRS Interpretations Committee observed that the definitions of ‘accounting policies’ and ‘changes in accounting estimates’ are not sufficiently clear resulting in diversity in the way entities distinguish accounting policies from accounting estimates.

Therefore, the International Accounting Standards Board (IASB) initiated a project to amend IAS 8 in order to provide further clarity on this subject.

New development

On 12 September 2017, the IASB proposed amendments to IAS 8 by issuing an Exposure Draft ED/2017/5 Accounting Policies and Accounting Estimates (ED). The ED is expected to help entities distinguish accounting policies from accounting estimates.

Overview of the amendments

The ED proposes following amendments to IAS 8:

- **Change in the definition of an accounting policy:** Currently, IAS 8 defines accounting policies as ‘the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.’

  The ED proposes to remove the terms ‘conventions’ and ‘rules’ as their meanings are not clear and these terms are not used elsewhere in International Financial Reporting Standards (IFRS). Additionally, it proposes to add the term ‘measurement’ before bases in the above definition in accordance with the paragraph 35 of IAS 8 which states that a change in the measurement basis applied is a change in an accounting policy.

  Accordingly, post amendment, an accounting policy would be defined as ‘the specific principles, measurement bases, and practices applied in preparing and presenting financial statements.’

- **New definition of an accounting estimate:** Currently, IAS 8 defines ‘accounting policies’ and a ‘change in accounting estimate’ but does not define ‘accounting estimates’.

  The IASB observed that the combination of a definition of one item (i.e. accounting policies) with a definition of changes in another item (i.e. changes in accounting estimates) obscures the distinction between accounting policies and accounting estimates. In order to make the distinction clear, the ED proposes a definition of ‘accounting estimates’ and removes the definition of ‘a change in accounting estimate.’

  Accounting estimates have been defined in the ED as ‘judgements or assumptions used in applying an accounting policy when, because of estimation uncertainty, an item in financial statements cannot be measured with precision.’

  The definition includes reference to the inability to measure items in financial statements with precision. In this context, IASB noted that the level of precision associated with accounting estimates would vary with certain cases having a relatively high level of precision.

- **Clarification for items that cannot be measured with precision:** The ED recognises that the selection of an estimation or valuation technique to measure an item in the financial statements that cannot be measured with precision, involves the use of judgements or assumptions in applying the accounting policy for that item.

  Therefore, the ED clarifies that selection of such an estimation or valuation technique constitutes making an accounting estimate.

- **Clarification for inventories:**

  The ED clarified that in applying IAS 2, Inventories, selecting the First-In, First-Out (FIFO) cost formula or the weighted average cost formula for interchangeable inventories would be selection of an accounting policy.

  Selecting one of the two cost formulas prescribed by paragraphs 25 - 27 of IAS 2 for ordinarily interchangeable inventories does not involve the use of judgement or assumptions to determine the sequence in which those inventories are sold. For this reason, selecting that cost formula does not constitute making an accounting estimate, it constitutes selecting an accounting policy.
• **Others:** The ED also proposes to delete an example from the guidance on implementing IAS 8. The example deals with the following two simultaneous changes for property, plant and equipment:
  
  a. Adopting the revaluation model and
  
  b. Applying a components approach more fully for depreciation purposes.

**Applicability**

The ED proposes that an entity should apply the amendments only to changes in accounting policies and changes in accounting estimates that occur on or after the start of the first annual period in which the entity applies the amendments.

(Source: IASB Exposure Draft ED/2017/5 Accounting Policies and Accounting Estimates (ED) dated 12 September 2017 and KPMG in India’s IFRS Notes dated 20 September 2017)

**SEBI amends ICDR Regulations**

The Securities Exchange Board of India (SEBI) through its notification dated 14 August 2017 issued SEBI (Issue of Capital and Disclosure Requirements) (ICDR) (Fourth Amendment) Regulations, 2017 to amend SEBI ICDR Regulations, 2009. The amendments are with respect to Chapter VII of the ICDR Regulations which relates to preferential issue. Regulation 70 of ICDR Regulations specifies the situations where the provisions of Chapter VII are not applicable.

The notification amends Regulation 70 of ICDR Regulations and provides that the ‘preferential issues’ chapter of the ICDR Regulations will not be applicable to following preferential issues, subject to condition mentioned under the amended regulations:

- Preferential issues of equity shares is made in terms of rehabilitation scheme approved under the Sick Industrial Companies (Special Provisions) Act, 1985 or against resolution plans which are approved by the Tribunal under the Insolvency and Bankruptcy Code, 2016, whichever is applicable.

- Earlier the provision relating to preferential issue was not applicable where preferential issues made to lenders pursuant to conversion of their debt, as part of a debt restructuring scheme will be covered. (Regulation 70(5) of ICDR Regulation)

- Earlier the provision relating to preferential issue was not applicable where preferential issues were made to other secured lenders (apart from the consortium of lenders mentioned above) who opt to join the strategic debt restructuring scheme, with the amendment, the amended regulation includes lenders who received securities as part of the debt restructuring scheme and are selling those securities to specified persons. (Regulation 70(6) of ICDR Regulation)

(Source: SEBI notification No.SEBI/ LAD-NRO/GN/2017-18/016. dated 14 August 2017)

**SEBI approved amendments to the SEBI (Infrastructure Investment Trusts) Regulations, 2014 and SEBI (Real Estate Investment Trusts) Regulations, 2014**

In order to facilitate growth of Infrastructure Investment Trusts (InvITs) and Real Estate Investment Trust (REITs), SEBI in its board meeting held on 18 September 2017, has approved certain changes in the SEBI (Infrastructure Investment Trusts) Regulations, 2014 and SEBI (Real Estate Investment Trusts) Regulations, 2014. The changes, which, inter alia, include the following:

- Allowing REITs and InvITs to raise debt capital by issuing debt securities

- Introducing the concept of ‘strategic investor’ for REITs on similar lines of InvITs

- Allowing single asset REIT on similar lines of InvIT

- Allowing REITs to lend to underlying Holdco/Special Purpose Vehicle (SPV)

- Amending the definition of valuer for both REITs and InvITs.

Further, SEBI after deliberations, decided to have further consultation with the stakeholders on a proposal of allowing REITs to invest at least 50 per cent of the equity share capital or interest in the underlying Holdco/SPVs, and similarly allowing Holdco to invest with at least 50 per cent of the equity share capital or interest in the underlying SPVs.

(Source: SEBI press release PR No.: 57/2017 dated 18 September 2017)
CBDT extended the due date for filling of return of income and various reports of audit

The Central Board of Direct Taxes (CBDT) through its notification dated 31 August 2017 in respect of all the assessees covered under Explanation 2(a) to Section 139 (1) of the Income-tax Act, 1961 (IT Act) has extended the due date prescribed therein for filing the return of income as well as various reports of audit prescribed under IT Act which are required to be filed by the said due date from 30 September 2017 to 31 October 2017.

(Source: Order under Section 119 of the IT Act dated 31 August 2017)

MCA issued National Company Law Appellate Tribunal (Amendment) Rules 2017

The MCA on 21 July 2016 has notified the rules corresponding to the sections relating to NCLT/NCLAT. They are as follows:

1. National Company Law Tribunal Rules, 2016 (NCLT Rules) and

The Rules provide the procedures that companies would be required to follow while making an application to the NCLT/NCLAT along with the manner in which the cases would be disposed of by the NCLT/NCLAT.

Section 432 of the 2013 Act and Rule 63 of the NCLAT Rules provide that a party to any proceeding or appeal before the NCLT/NCLAT, as the case may be, may either appear in person or authorise one or more Chartered Accountants (CAs) or Company Secretaries (CSs) or cost accountants or legal practitioners or any other person to present his case before NCLT/NCLAT.

New development

The MCA through its notification dated 29 June 2017 issued the National Company Law Appellate Tribunal (Amendment) Rules, 2017 to amend the National Company Law Appellate Tribunal Rules, 2016. The amendment added following to the current provisions which provides that:

• The central government, the regional director or the Registrar of Companies (ROC) or the official liquidator shall be an officer not below the rank of Junior Time Scale or company prosecutor.

Additionally, the provisions of Section 212(8), 212(9) and 212(10) have been made effective from 24 August 2017. These relate to the procedure for arrest and subsequent presentation to the Magistrate’s office of a person found guilty of committing fraud (Section 447 of the 2013 Act) by a Serious Fraud Investigation Office appointed by the central government.

(Source: MCA notification G.S.R. 1061(E) and S.O. 2751(E) dated 24 August 2017)
KPMG in India’s IFRS institute

Visit KPMG in India’s IFRS institute - a web-based platform, which seeks to act as a wide-ranging site for information and updates on IFRS implementation in India.

The website provides information and resources to help board and audit committee members, executives, management, stakeholders and government representatives gain insight and access to thought leadership publications that are based on the evolving global financial reporting framework.

First Notes

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

20 September 2017
On 12 September 2017, the IASB proposed amendments to IAS 8 by issuing an Exposure Draft ED/2017/8, Accounting Policies and Accounting Estimates (ED). International Accounting Standard (IAS) 8, Accounting policies, Changes in Accounting Estimates and Errors contains different requirements on how to account for changes in accounting policies and for changes in accounting estimates. However, the IFRS Interpretations Committee observed that the definitions of ‘accounting policies’ and ‘changes in accounting estimates’ are not sufficiently clear resulting in diversity in the way entities distinguish accounting policies from accounting estimates.

Therefore, the International Accounting Standards Board (IASB) initiated a project to amend IAS 8 in order to provide further clarity on this subject.

The ED is expected to help entities distinguish accounting policies from accounting estimates.

Comments on the ED may be submitted to the IASB by 15 January 2018.

This issue of IFRS Notes provide an overview of the amendments proposed to IAS 8.

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

Feedback/queries can be sent to
aaupdate@kpmg.com

Follow us on:
kpmg.com/in/socialmedia

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2017 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.

This document is meant for e-communication only.