

ACCOUNTING AND AUDITING UPDATE

July 2015

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cutting through complexity



EDITORIAL

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This month, we have a very wide selection of topics in the Accounting and Auditing Update, which is reflective of how fast moving recent changes in the area of reporting have been. Some of the changes focus on developments internationally which have an impact on Indian entities, and some are focussed on developments within the country.

The FASB and the IASB have confirmed deferment of the new revenue recognition standard by one year. The standards would mandatorily be applicable from 1 January 2018 instead of 1 January 2017. In India, based on current information, the equivalent Ind AS 115, *Revenue from Contracts with Customers* standard would still be applicable from 1 January 2016. Recently, the FASB has issued proposals to clarify the guidance on accounting for licences of intellectual property and identifying performance obligations. In this edition of the Accounting and Auditing Update, we provide a summary of these proposals along with the decisions of the IASB on how to address these issues under IFRS.

In India, the new revenue standard Ind AS 115 would require companies to assess how their financial reporting, information systems, processes and internal controls will be affected. This month we highlight the main areas which would affect the transport and logistics industry.

In addition to the above, we have also analysed the key impact of the Ind AS implementation on government grants, and also highlight the corresponding requirements of Income Computation and Disclosure Standards applicable with effect from 1 April 2015.

Schools are vital institutions of our society. In this edition, we cast our lens on the areas of accounting and regulatory requirements relating to schools in India.

The Reserve Bank of India has recently allowed banks to undertake a Strategic Debt Restructuring (SDR) scheme by converting loan dues to equity shares. In this issue of the Accounting and Auditing Update, we cover the guidelines for effective implementation of the SDR scheme by banks.

Apart from our regular round up of regulatory updates, this edition also provides an overview of the new requirements on auditor's report issued by the International Auditing and Assurance Standards Board (IAASB).

As always, we would request you to share your suggestions and/or inputs on topics we cover, we would be delighted to hear from you.

Accounting and regulatory requirements relating to schools

This article aims to:

- Highlight key aspects relating to accounting under Indian GAAP and regulatory requirements relating to operations of schools in India.



Introduction

Schools, lay the foundation of the entire education system. For carrying out their activities, schools receive large amount of funds mainly from various sources like students, government (in the form of concessions and incentives) and other grants from corporates, etc. At present, there are a number of primary and secondary schools in the country, who form part of the K-12 school system. The issues involved in accounting and financial reporting of majority of the schools are more or less common.

This article summarises the accounting and regulatory framework applicable to a school. Further, we have discussed certain regulatory aspects, non-compliance of those aspects could lead to severe consequences for the school's management. There could be levy of penalties and cancellation of registration/affiliation under Indian laws like State Education Acts, the Income Tax Act, 1961, the Societies Registration Act, 1860, etc.



Accounting framework and basis of accounting for schools

In practice, there is lack of awareness on applicability of accounting standards and thus, due to adoption of different basis of accounting such as cash, hybrid, accrual, etc. and influence of tax and other laws, there exists diversity in accounting practices followed by schools. Therefore, information provided in the financial statements by different schools may not be comparable.

The Institute of Chartered Accountants of India (ICAI) issued a guidance note on accounting by schools (guidance note). The guidance note states that it is often argued that since profit is not the objective of schools, the accounting framework, which is relevant for business entities is not effective for schools. However, as far as the recognition principles are concerned, it is felt that there is no difference in preparing the financial statements of business entities and not-for-profit organisations such as schools.

Generally, in our experience, we have seen that many schools are registered as trusts or societies with the exceptions in some states like Haryana where companies are also permitted to open a school.

For presentation in the financial statements, considering that many schools are generally funded by numerous grants, donations or similar contributions, which may or may not impose conditions on their usage; schools generally follow 'fund based accounting', a system whereby the financial statements of the schools reflect income, expenses, assets and liabilities separately so as to enable the users of the financial statements such as the contributors, to assess the usage of the funds contributed by them. However, it may be noted that fund based accounting is relevant primarily for the purpose of presentation of financial statements and not for the purpose of identification, recognition and measurement of various items of income, expenses, assets and liabilities.

Basis of accounting

The term 'basis of accounting' refers to the timing of recognition of revenue, expenses, assets and liabilities in the financial statements. The two commonly followed bases of accounting are:

- a. cash basis of accounting,
- b. accrual basis of accounting

According to the guidance note, accrual basis of accounting is the scientific basis of accounting and has conceptual superiority over cash basis of accounting. Therefore, guidance note recommends that all schools should maintain their books of account on accrual basis for all elements of financial statements.

Fund accounting (general funds, designated funds and restricted funds)¹

Schools frequently receive grants/donations and other forms of revenue, the use of which may either be unrestricted or subject to restrictions imposed by the contributors, i.e. such funds can only be used for specific purposes and, therefore, are not available for a school's general purposes. Further, there might also be legal/other binding restrictions on a school to use certain explicit amounts only for specified purposes or a school may also on its own, earmark certain unrestricted funds for specific purposes. Funds are of the following types:

Unrestricted funds - Unrestricted funds refer to funds contributed to a school with no specific restrictions. These funds can be further reclassified into the following categories:

Designated funds - These are unrestricted funds which have been set aside by the trustees/management of a school for specific purposes or to meet future commitments. Unlike restricted funds, designations are self-imposed and are not normally legally binding. The school can lift the designation whenever it wishes and reallocate the funds for some other designated purpose.

When revenue expenditure is incurred with respect to a designated fund, the same is debited to the income and expenditure account and relevant asset account is debited where the designated fund has been created for meeting a capital expenditure. A corresponding amount is transferred from the concerned designated fund account to the credit of income and expenditure account after determining the surplus/deficit for the year since the purpose of the designated fund is over to that extent.

General funds - Unrestricted funds other than 'designated funds' are part of the 'general fund'.

All items of revenue and expenses that do not relate to any designated fund or restricted fund are reflected in the 'general fund' column of the income and expenditure account. The surplus/deficit for the year after appropriations is transferred and presented as surplus/deficit separately as a part of 'general fund' in the balance sheet. Apart from such surplus/deficit, the 'general fund' also includes the following which are separately presented in the balance sheet:

- i. Grants related to a non-depreciable asset. However, if a grant related to a non-depreciable asset requires fulfilment of certain obligations, the grant should be treated as deferred income which should be recognised as income over the same period over which the cost of meeting such obligations is charged to income.
- ii. Grants of the nature of promoters' contribution.

1. Guidance Note on accounting by schools issued by the Institute of Chartered Accountants of India (ICAI), July 2005

Restricted funds - Restricted funds are subject to certain conditions set out by the contributors and agreed to by the school when accepting contributions. The restriction may apply to the use of the money received or earned from the investment of such money or both. Funds, the use of which is subject to legal restrictions, are also considered as restricted funds.

When revenue expenditure is incurred with respect to restricted fund, upon incurrance of such expenditure, the same is charged to the income and expenditure account ('restricted funds' column); a corresponding amount is transferred from the concerned restricted fund account to the credit of the income and expenditure account. Where the fund is meant for meeting capital expenditure, upon occurrence of the expenditure, the relevant asset account is debited. Thereafter, the concerned restricted fund account is treated as deferred income, to the extent of the cost of the asset and is transferred to the credit of the income and expenditure account in proportion to the use of depreciation charged every year. The unamortised balance of deferred income would continue to form part of the restricted fund. These restricted funds normally carry a stipulation as to the use of income earned on investments made out of the contributions received. If the terms stipulate that the income earned should

be used for the same purpose for which the contribution was made, the income earned should be credited to the concerned restricted fund account. Where the terms stipulate a general use of the income earned, the same should be credited to the income and expenditure account ('general fund' column) of the year in which the income is so earned.

Common observations relating to financial reporting of the schools

Revenue recognition

Schools earn income through various types of fees such as application fee, registration fee, admission fee, tuition fee, library fee, developmental charges, etc. The guidance note recommends that where there is no further involvement expected from the school, e.g. application fee, registration fee, etc. and where such fees are not refundable, the same should be recognised as revenue on receipt. However, processes where schools have a continuous involvement and obligation to provide related services over a period, such as tuition fee should be recognised over the period over which services are expected to be rendered and the amounts received in advance should be shown as a liability. Examples of fees and related revenue recognition principles are given in the table below:

Type of fee	Treatment
Tuition fee	To be recognised over the period of instruction (academic year).
Annual fees for services such as library, computer lab, etc.	To be recognised over the period over which such facilities are to be provided.
Admission fee (non-refundable)	To be recognised on receipt, as there is no continuing obligation to render any service.
Registration fee (non-refundable)	To be recognised on receipt, as there is no continuing obligation to render any service.
Other annual charges	To be recognised over the period over which related services are to be provided.
Sale of prospectus/admission forms (non-refundable)	To be recognised on receipt, as there is no continuing obligation to render any service.
Activity charges	To be recognised as income when related services are rendered/activities undertaken.
Bus fee	In case, own buses are used or buses are taken on rent, bus fee should be recognised as income when related services are rendered.
	In case the school has arranged buses through a contractor on a fixed income basis, the fee collected from students is usually passed on to the contractor and the contractor pays a fixed amount on pre-determined intervals. In such cases, the fee collected from students does not form part of the school's revenue and is accounted as a payable to the contractor. The contract charges received from the contractor is recognised as an income on a time proportion basis.
Sale of books, uniforms, etc.	Similar to above, in case the school sells books, uniforms, etc. through its own shop, revenue is accounted for when the sale takes place. In case, the same is contracted to a third party, the revenue is recognised in terms of agreement entered into with that party, i.e. in case, it is a fixed income contract, the revenue is recognised on a time proportion basis over the contract period. In case, the school receives commission on the sale of such goods, revenue should be recognised when the contractor makes the sale and intimates the school.
Sponsorship charges and advertisement fee	Such charges should be recognised as income when the related event takes place or the advertisement is printed and circulated.

Source - Guidance note on accounting by schools issued by the Institute of Chartered Accountants of India (ICAI), July 2005



While the above guidance is general in nature, based on principles contained in Ind AS and IFRS, a school should apply judgement while recognising one-time fees i.e. should take into consideration the costs incurred and recognise appropriate margin.

Current/non-current classification of caution money

Schools collect caution money from students which is refundable at the time of completion of school or taking transfers.

Paragraph 31 of the guidance note states that *'the amount of caution money refundable to students within 12 months of the balance sheet date should be reflected as a 'current liability' in the balance sheet and the caution money refundable beyond 12 months of the balance sheet date should be shown separately as a liability of long-term nature in the balance sheet'*.

Interest earned on designated funds

Schools receive funds from students in various forms such as management fund, development fund, scholarship fund, PTA fund, etc. These funds are unrestricted in nature but are designated as per the policy of the schools.

Normally, the unutilised amount is deposited as fixed deposit with banks and interest earned on those deposits is credited directly to outstanding fund balance at the end of the year.

As per paragraph 97 of the guidance note, *'In case the school is holding specific investments against the designated funds, income earned, if any, on such investments, is credited to the income and expenditure account for the year in which the income is so earned and is shown in 'designated funds' column. An equivalent amount may be transferred to the concerned designated fund account after determining the surplus/deficit for the year as per the policy of the school'*.

However, in practice, income earned on these funds by schools is recognised directly in a fund account. As per the guidance note, income earned should be credited to income and expenditure account and thereafter may be transferred to the concerned fund account after determining the surplus/deficit for the year.

Actuarial valuation of retirement benefits

As per sub-clause (a) of clause (iii) of paragraph 60 of the guidance note, *an appropriate charge to the income and expenditure account for a year should be made through a provision for the accruing liability. The accruing liability should be calculated according to actuarial valuation. However, if a school employs only a few people, say less than 20, it may calculate the accrued liability by reference to any other rational method, e.g., a method based on the assumption that such benefits are payable to all employees at the end of the period.*

AS 15, *Employees Benefits* issued by the ICAI establishes requirements for the basis of the valuation as well as principles about the actuarial assumptions that should be used in valuing defined benefit plans.

Contingent liabilities

If schools do not have robust processes in place for identifying off balance sheet items/litigations and their potential exposure, then adequate disclosure would not be made in the notes to accounts.

As per paragraph 83 of the guidance note, the following should be disclosed:

- a. a brief description of the nature of the contingent liability
- b. an estimate of its financial effect
- c. an indication of the uncertainties relating to any outflow, and
- d. the possibility of any reimbursement.

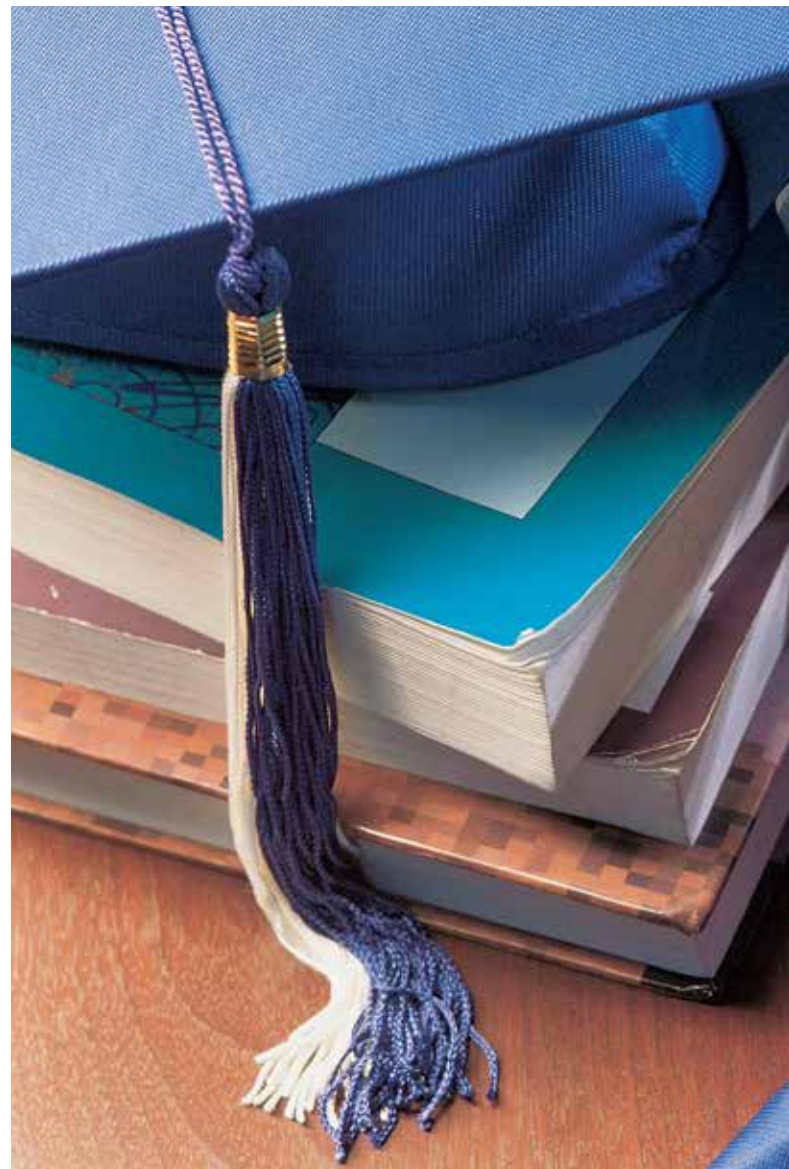
Related party transactions

If schools do not have robust systems of obtaining declarations from concerned persons to identify related party transactions, then it may become a challenge to carry out an independent verification to help ensure completeness of disclosures required to be made as per AS 18, *Related Party Disclosures* and paragraph 103 to the guidance note.

As per paragraph 103 of the guidance note, the following disclosures should be made by way of a note to the financial statements of the school:

- i. Transactions between the school and the trust or society managing the school.
- ii. Transactions between the school and the trustees or the members of the governing body of the school.
- iii. Transactions between the school and the author of the trust or the founder of the institution.
- iv. Transactions between the school with another school or any other educational entity managed by the same trust or society, if permitted by the relevant legislation/bye-laws, etc.

- v. Transactions between the school and the relatives of the trustees, or members of the governing body managing the school or the author of the trust or the founder of the institution. For this purpose, a relative, in the context of an individual, means the spouse, son, daughter, brother, sister, father and mother who may be expected to influence, or influenced by, that individual in his/her dealing with the school.
- vi. Transactions between the school and its 'key management personnel' or the relatives of the key management personnel. Key management personnel would represent those persons in the school who have the authority and responsibility for planning, directing and controlling the activities of the school. In case of a school, an example of key management personnel is the principal.



Compliance with laws

State's Education Act and boards to which schools are affiliated

Schools are required to comply with the State's Education Act and also with the mandates set by the affiliated boards. Non-compliance with any of these could result in penalties being imposed by the State authorities, which could also affect the functioning of the school, including loss of affiliation to the boards. Every school is required to file various compliance forms with the education authorities, annually, including disclosure of the fees charged for the academic year. Generally, State's Education Act, also recommends regular inspection of schools by an education officer. For example, some of the key compliance requirements relating to the Delhi school education rules are described below:

- Every existing school shall be deemed to have been recognised under the Act and shall be subject to the provisions of this Act and the rules made thereunder.

- No private school shall be recognised, or continue to be recognised, by the appropriate authority unless the school is run by a society registered under the Societies Registration Act, 1860, or a public trust constituted under any law for the time being in force and is managed in accordance with a scheme of management made under these rules.
- Schools are not run for the profit to any individual or group.

Compliance with labour laws

Many schools hire labour (including teaching staff) on a contract basis and thus schools need to comply with the applicable labour laws, including provident fund, gratuity, etc. for such staff employed on temporary basis.

Compliance with the Right of children to free and compulsory education Act, 2009 and related rules

Every school is required to comply with the provisions of the Right of education to free and compulsory education Act, 2009 (RTE Act).

The above Act makes education a fundamental right of every child between the ages of 6 and 14 and specifies minimum norms in elementary schools. Section 12(1)(c) within the RTE Act mandates that 25 per cent of entering class seats to be opened for children from weaker sections of the society and disadvantaged groups in the neighbourhood and provide free and compulsory elementary education.

Others

There could be other issues also like contributions/funding from overseas institutions (under Foreign Contribution Regulation Act). Also, there are other issues such as compliance with Trust Act, Societies Act, Income Tax Act, when it comes to receiving funds or making investments and compliance with exempt from tax status under Section 12A of the Income Tax Act.

Conclusion

As is evident from above, schools like any other organisation, are required to follow a similar accounting framework for measurement and recognition principles as are applicable to commercial organisations. In some elements of the financial statements, the presentation and disclosure requirements may differ.



Transportation and logistics industry - Transition to the new revenue standard Ind AS 115¹

This article aims to:

- Discuss the main areas where there could be an impact due to adoption of Ind AS 115, *Revenue from Contracts with Customers* in the transportation and logistics industry.



Main areas which are likely to be impacted



Service concession arrangements



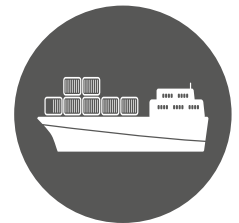
Ticket breakage



Rebates



Ancillary services and extra charges



Freight and shipping

Overview

With the road map of adoption of Ind AS firmly in place, the transport and logistics sector will have to start preparing for the transition to the new framework, with additional focus on ensuring compliance with Ind AS 115, *Revenue from Contracts with Customers* which introduces new principles for revenue recognition.

In this article, we have dwelled upon areas around revenue recognition, which would be relevant to the transport and logistics industry. The industry will need to carefully consider the impacts of the new standard and assess how their

financial reporting, information systems, processes and internal controls will be affected. Further, the new disclosure requirements are extensive and might require changes to systems, processes and internal controls to collect and report the necessary data. Companies may need to engage with their stakeholders to establish expectations of how their key performance indicators or business practices may change under the new standard.

1. Accounting for revenue is changing - Impact on transport companies, KPMG in U.K., May 2015

The table below sets out a high level overview of Ind AS 115 and the application model for revenue recognition:

Overview of Ind AS 115	Five step model to help apply the standard	Differences from current practice
<ul style="list-style-type: none"> • A single global standard – contract-based five-step analysis of transactions, focussing on transfer of control • Two approaches to recognise revenue: at a point in time or over time • Significant judgement required • Extensive new disclosure requirements for all companies. 	<p>Step 1 Identify the contract with the customer.</p> <p>Step 2 Identify the performance obligations in the contract.</p> <p>Step 3 Determine the transaction price.</p> <p>Step 4 Allocate the transaction price to the performance obligations.</p> <p>Step 5 Recognise revenue when (or as) the entity satisfies a performance obligation.</p>	<ul style="list-style-type: none"> • All guidance is contained in a single standard • The new model is control-based (the ‘risks and rewards’ concept is retained as an indicator of control transfer) • Consideration is measured at the amount to which the entity expects to be entitled, rather than at fair value • Specific guidance is provided for: <ul style="list-style-type: none"> – separating goods and services in a contract – recognising revenue over time – licences; and variable consideration.



Understanding the impact

Service concession arrangements

Potential impact	Actions to be considered by the management
<ul style="list-style-type: none"> Service concession arrangements are those arrangements in which a private sector entity (the operator) builds or upgrades public service infrastructure. The operator typically receives cash either from the public sector body that awards the concessions (the guarantor) or from users, only once the infrastructure is available for use. Examples are toll roads, ports, etc. The operator does not recognise the property, plant and equipment constructed as part of the service concession arrangement. As per the contractual service agreement, the operator is considered to have a right to access rather than a right to use. The operator recognises and measures revenue and costs related to the construction or upgrade of infrastructure in accordance with the provisions of Ind AS 115, during the construction or upgrade period. The consideration may be right for a financial asset or an intangible asset. If the operator has paid for the construction services partly by a financial asset and partly by an intangible asset, it is necessary to account separately for each component of the operator's consideration. The consideration received for both the components will be accounted as per Ind AS 115. Ind AS 115 will affect an operators' revenue recognition and profit pattern during the period of the arrangement. The change in the profit profile could also impact the timing or ability to pay dividends in certain years during the term of the project. Additionally, the operators' balance sheet composition will also change, as assets previously classified as fixed assets will be separately classified as financial assets or intangible assets. The accounting for service concession arrangements under Ind AS will significantly alter some of the key ratios in the financial statements of the operators, which may require re-negotiation of loan covenants with lenders. 	<ul style="list-style-type: none"> Analyse the contractual arrangements with the grantor to determine the appropriate timing and basis for revenue recognition which will have to be split between revenue during construction period and revenue during operating period. Assess whether the company will have to recognise an intangible or financial asset and assess the impact of derecognising the property, plant and equipment. Review the debt covenants with the lenders, given that in many cases the fixed assets recognised under the current framework could be offered as security.

Customers' unexercised rights (breakage)

Potential impact	Actions to be considered by the management
<ul style="list-style-type: none"> Unexercised rights are non-refundable pre-payments received from customers that give the customers a right to receive goods or services in the future, e.g. a gift voucher, or a ticket to travel at a future date. Some tickets are not used to travel and cannot be refunded. This is often referred to as 'ticket breakage'. There is no specific guidance under Indian GAAP for such an incident. Ind AS 115 includes specific guidance on revenue related to ticket breakage that may result in changes for some transport companies. When the entity has such a liability, it either recognises revenue when the rights are exercised by the customer or when the entity determines that the likelihood of the customer exercising its rights is remote. If a passenger transport company expects to be entitled to breakage, then the estimated amount is recognised as revenue, to the extent it is highly probable that there will be no significant revenue reversal. For example, if an airline expects that some tickets will not be used, for the entire or part of a journey, and it can make a sufficiently reliable estimate, then it would recognise breakage revenue prior to ticket expiry, e.g. on intended departure date. However, if a passenger transport company cannot estimate the breakage with sufficient confidence that there will be no significant revenue reversal, then any related revenue is recognised only when the likelihood of the customer exercising its remaining rights becomes remote, e.g. if an airline cannot estimate breakage with sufficient reliability, then it recognises breakage revenue on ticket expiry. 	<ul style="list-style-type: none"> Consider if data is available to estimate the level of breakage with sufficient reliability and fair degree of certainty. Re-look at the IT architecture to mine data in respect of past customer experience for such breakage. Consider whether the current accounting for breakage revenue remains acceptable under the new standard. Consider whether new internal controls need to be established around the breakage data.

Customer loyalty programmes

Potential impact	Actions to be considered by the management
<ul style="list-style-type: none"> Many passenger transport companies have loyalty programmes, wherein the passengers get free mileages/privilege points by flying with the airline and these points can be utilised in the future against free tickets in the same or any other airline participating in the same frequent flyer programme (FPP) within the specific period of time. In some other programmes, the passengers also have flexibility to utilise points against other goods and products. Under Indian GAAP, the ICAI has issued a technical guide on Accounting Issues in the Retail Sector (guide). This guide provides guidance for customer loyalty programmes. It mentions that currently in India, deferment model and provision model are prevalent. Deferment model is on the lines of IFRIC 13, <i>Customer Loyalty Programmes</i>. In this model when a company grants loyalty points with the purchase of a passenger ticket, the loyalty points are separated from the passenger ticket and accounted for as a separate performance obligation (multiple element transactions). Under the provision model, sale is treated as a single element transaction and recognise revenue for the entire transaction at the time of initial sale. However, since a further cost is expected to be incurred in future with regard to the obligation to provide free/discounted goods or services, a provision is recognised towards the cost of such free/discounted goods or services as marketing expense at the time of initial sale. According to the guide, the deferment model being more refined is a preferred model, though it does involve complex workings to arrive at the fair value of the award credits/obligations to be fulfilled in future. In case, reliable data is not available or the estimation of fair value of the award credits presents significant difficulties, provision model may be used. In practice many airlines and other entities with similar programmes, create provision on an estimated incremental cost basis at the time of recognising revenue from sale of underlying tickets. The guidance on customer loyalty programmes in the new standard is broadly similar to IFRIC 13. Under the new requirements of Ind AS 115, the amount of consideration allocated to loyalty points is based on the relative stand-alone selling price of the loyalty points and takes into account the likelihood of redemption. This may not always be easy to establish. Possible methods include the stand-alone price at which loyalty points are sold to third parties, such as credit card companies who give miles for qualifying spend, or estimates based on cost and a reasonable margin. The residual approach to allocate consideration between the sales transaction and the loyalty points is allowed under the new standard, but a transport company needs to meet specified criteria in order to use it and that may be a challenge. 	<ul style="list-style-type: none"> Consider whether the current accounting for loyalty programmes remains acceptable under the new standard. Transport companies that have loyalty programmes should assess whether the allocation method that they currently apply remains acceptable under the new standard. Many loyalty programmes are unlikely to meet the criteria for the residual method. For multi-party schemes, only the selling party is considered under the new standard, with buyers of customer loyalty programme points, e.g. credit card companies needing to refer to other guidance, such as that on inventory and cost of sales, to determine the appropriate accounting.

Rebates

Potential impact	Actions to be considered by the management
<ul style="list-style-type: none"> Some transport companies provide rebates to their customers, e.g. when a customer reaches a specified threshold of tonnage shipped or tonnage provided to a container freight station (CFS), it gets back 5 per cent of the fees paid. Under the new standard, rebates are treated as variable consideration. Variable consideration is included in the transaction price at the transport company's best estimate and is included in revenue only to the extent it is highly probable that there will be no significant revenue reversal. The new requirements for variable consideration may change the profile of revenue recognition for some transport companies. For example, it may be necessary to assume a higher level of rebates and recognise less revenue in the early periods compared to current practice, particularly if the transport company is dealing with a new customer or entering a new market and so has less relevant experience on which to base its estimates. 	<ul style="list-style-type: none"> Review arrangements involving rebates and determine their impact on the transaction price. Consider whether the systems are capable of providing data for estimating variable consideration, including rebates. Consider whether new internal controls are needed to support the estimates.

Ancillary services and extra charges

Potential impact	Actions to be considered by the management
<ul style="list-style-type: none"> • Many passenger transport companies provide a number of ancillary services either as part of the ticket fare or at an extra charge, e.g. lounge access on the day of travel, meals, terminal transfers, Wi-Fi access, seat assignment or upgrades, extra baggage and ticket changes. For many of these items, revenue is currently recognised at the time of travel, however, for some items revenue is recognised at the time the service is provided and charges are collected, e.g. ticket changes. The new standard may result in a change for some of these items. • Under the new standard, a transport company needs to determine if ancillary services or extra charges are distinct from the transportation services and should be accounted as separate performance obligations. • If they are not, then revenue for these items is recognised in line with the journey. • The new requirements may also impact the disaggregation of revenue in the financial statements. For example, if an airline has previously presented ancillary revenue separately to passenger revenue, it may consider whether it would be more useful to the users of the financial statements if all revenue from the same performance obligation were presented as a single line item in the statement of comprehensive income. 	<ul style="list-style-type: none"> • Review arrangements involving ancillary services and extra charges to identify performance obligations under the new standard. Develop new processes and adjust systems and internal controls to capture, estimate and monitor standalone selling prices to allocate the transport price to the performance obligations in the contract. • Assess whether billing management and related systems and internal controls are capable of supporting the allocation methodology and generation of information needed to allocate revenue. • Determine if the presentation of revenue from ancillary services in the financial statements needs to be revised under the new standard.

Freight and shipping

Potential impact	Actions to be considered by the management
<ul style="list-style-type: none"> • There is currently diversity in practice in accounting for freight and shipping contracts – some transport companies recognise revenue at the point in time when goods are delivered, while others recognise revenue over time e.g. based on voyage days. • A shipping company needs to consider various factors in the new standard to determine when it transfers control over goods and services to the customer, including whether another company would need to substantially re-perform work if it were to fulfil the remaining performance obligation. • Under the new standard, it would be difficult for a transport company to justify recognition of revenue only on completion of the full bundle of services. • In the usual case where a transport company determines that revenue from freight or shipping services should be recognised over time, the next matter to consider is the appropriate measure of progress i.e. voyage days or cost. This may be a challenge because some voyages involve both land and sea, and costs for different parts of the voyage may differ. 	<ul style="list-style-type: none"> • Analyse the contractual arrangements for freight and shipping services to determine the appropriate timing and basis for revenue recognition under the new standard. • Assess whether billing management and related systems and internal controls are capable of supporting revenue recognition over time, if applicable.

Key impacts	Immediate next steps	In nutshell
<ul style="list-style-type: none"> Revenue recognition may be accelerated or deferred. Revenue may be recognised at a point in time or over time. New estimates and judgements required. Changes to systems and processes Tax planning, dividends and staff incentive plans may be affected. 	<ul style="list-style-type: none"> Perform accounting impact assessment on your financial statements. Choose a transition approach. Determine the impact on your people, systems and processes. Communicate with stakeholders. 	<ul style="list-style-type: none"> Impacts may be felt right across the organisation. All financial ratios may be affected, which could impact your share price and access to capital. Start reviewing your contracts now.



Accounting for government grants

This article aims to:

- Provide an overview of the changes that are proposed to be introduced with Ind AS implementation in India with respect to government grants.
- Briefly discuss the requirements under income computation and disclosure standards applicable from 1 April 2015.
- Highlight key areas of difference between Ind AS and IFRS.



Background

Government grant is defined as an assistance that is received by an entity in cash or kind from the government for past or future compliance with certain conditions. Government refers to any government, or its agencies and similar bodies, irrespective of them being local, national or international. Terms such as subsidies, cash incentives, duty drawbacks, etc., usually qualify to be classified as government grants.

Under the current accounting standards, as per the Generally Accepted Accounting Principles in India (hereafter, Indian GAAP), AS 12, *Accounting for Government Grants* provides the requisite guidance on accounting for government grants. Under Indian Accounting Standards (Ind AS), the corresponding standard on this topic is Ind AS 20, *Accounting for Government Grants and Disclosure of Government Assistance*. Both these standards are based on certain common principles which are discussed below:

- Both standards do not permit recognition of a grant unless there is a reasonable assurance of the entity's compliance with the conditions attached to the grants and their actual receipt. The standards state that mere receipt of a grant would not constitute conclusive evidence that the conditions attached to the grant have been/will be fulfilled.

- Grants are bifurcated into two categories - capital and income. Within capital approach, Indian GAAP also discusses grants in the nature of promoters' contribution.
- Grants related to income are recognised in the statement of profit and loss in a systematic basis over the periods in which the related costs (i.e. those costs that the grant intends to compensate) are incurred by the entity.
- Grants receivable as compensation for expenses or losses incurred or for the purpose of giving immediate financial support to the entity with no future related costs are recognised in the statement of profit and loss in the period in which such a grant becomes receivable.

Despite these similarities, there are certain significant differences between AS 12 and Ind AS 20 which are discussed in this article.

Key impact areas on Ind AS implementation

Grants in the nature of promoters' contribution

As mentioned above, under both Indian GAAP and Ind AS, grants are bifurcated into capital grant (i.e. asset related) and income grant. However, Indian GAAP states that grants which are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay for which no repayment is ordinarily expected should be credited directly to the shareholders' funds (reserves). Ind AS does not include such a concept and hence requires all grants to be categorised as either related to assets or related to income.

Accounting for grants related to assets

With respect to grants related to specific fixed assets, current guidance under AS 12 provides two options –

- 1) Present the grant in the balance sheet by showing it as a deduction from the gross value of the related asset and thereby arriving at the book value of that asset. In case, the grant received equals the cost of the asset, the asset would be then shown in the balance sheet at a nominal value.
- 2) Treat the government grant as deferred income which is recognised in the statement of profit and loss in a systematic and rational basis over the useful life of the asset i.e. such grants should be allocated to income over the periods and in the proportion in which depreciation on those assets is charged.

Ind AS 20 requires presentation of such grants in the balance sheet only by setting up the grant as deferred income. Thus, the option to present such grants by deduction of the grant in arriving at the carrying amount of the asset is not available under Ind AS 20.

Under Ind AS and Indian GAAP, if the grant is presented as deferred income and such grant becomes refundable, then the amount refunded is required to be reduced from the deferred income balance with any excess refund being immediately

charged to the statement of profit and loss. Under Indian GAAP, if the grant is presented as a deduction of fixed asset, then an entity could account for repayment of government grant by increasing the book value of the asset, by reducing the capital reserve or the deferred income balance, as appropriate, by the amount refundable. Where the book value of the asset is increased, depreciation on the revised book value is provided for.

Further in Indian GAAP, a refund of government grant is required to be classified as an extraordinary item. However, under Ind AS, grant that becomes repayable should be accounted for as a change in accounting estimate.

Accounting for government loans with nil or below market rate of interest

It is common for the government to provide interest free or low interest loans (such as interest free sales tax deferral schemes) to entities, in order to encourage development in the backward areas, etc. Currently, under Indian GAAP, such loans are accounted at their transaction value. Under Ind AS, the difference between the nominal value of such loans and their fair value would qualify to be a government grant which would need to be amortised over the period of the loan like an income grant. Consistent with the requirements applicable to all financial instruments, the initial carrying value of the loan (fair value at inception) is then accreted to its repayment value using the effective interest method.

As several entities would have such loans on their balance sheet on transition to Ind AS which would not have been fair valued under Indian GAAP, Ind AS 101, *First-time Adoption of Indian Accounting Standards* provides a mandatory exemption from retrospective application of the requirement to fair value such loans and requires use of the existing Indian GAAP carrying value on transition to Ind AS. However, if an entity has the information needed to fair value the loan at the time of initially accounting the loan, it may choose to retrospectively account for the loan using the guidance provided under Ind AS 109 and Ind AS 20.



Non-monetary assets at concessional rates received as grants

Under the current accounting principles, government grants in the form of non-monetary assets, such as land or other resources, given at concessional rates are required to be accounted at their acquisition cost. Further, if any non-monetary asset have been given free of cost, then AS 12 requires them to be recognised at a nominal value.

Ind AS 20 requires both grant and asset to be accounted at their fair value.

Accounting for forgivable loans

Currently under AS 12, there is no guidance on accounting for forgivable loans and hence varied practices exist.

Ind AS provides specific guidance in this regard and states that forgivable loan should be treated as a government grant once there is a reasonable certainty that the entity receiving the forgivable loan will meet the terms for forgiveness of the loan.

Government assistance not related to operating activities of the entity

An Appendix to Ind AS 20 discusses a scenario in which government assistance is provided to an entity with the aim to encourage or support business activities of the entity in certain regions or industry sector with no conditions attached relating to the operating activities of the entity other than operating in those regions or industry sectors. The guidance states that the assistance provided in such a scenario would meet the definition of a government grant and should not be credited directly to shareholders' interest.

Currently under Indian GAAP, there is no specific guidance on such assistance.

Income computation and disclosure standards on government grants

The Central Board of Direct Taxes (CBDT) on 31 March 2015 issued a separate set of accounting standards referred to as the Income Computation and Disclosure Standards (ICDS) to be applied in computation of taxable income from 1 April 2015. While ICDS are primarily based on Indian GAAP, there are certain significant departures.

On the topic of government grants, the critical divergences from the current accounting practices/Ind AS requirements are briefly discussed below:

- ICDS similar to Indian GAAP/Ind AS prescribes a criteria for recognition of government grants i.e. reasonable assurance of receipt and compliance with conditions attached. However, unlike Indian GAAP/Ind AS, ICDS states that recognition of government grant should not be postponed beyond the date of actual receipt.





- Similar to Ind AS and unlike the Indian GAAP, ICDS do not recognise the concept of grants in the nature of promoters' contribution. Therefore, similar to Ind AS, grants under ICDS also need to be classified as either asset or income related grants.
- In case of grants relating to depreciable assets, Indian GAAP permits recognition as either net of actual cost of the asset or as deferred income. ICDS state that such grants should only be deducted from the actual cost of the asset or from the written down value of block of assets to which concerned asset belongs to. Ind AS, on the other hand, only permits treating such grants as deferred income.

Key differences between Ind AS and International Financial Reporting Standards (IFRS)

While Ind AS has been drafted on the lines of IFRS, it has certain critical carve-outs from IFRS which are discussed below:

- IFRS permits non-monetary government grants to be measured either at their fair value or at nominal value. Ind AS permits measurement of such non-monetary grants only at their fair value.
- Under IFRS, grants related to assets can be presented in the balance sheet either as a reduction from the carrying value of the asset or by setting up the grant as deferred income. Ind AS allows grants to be presented as deferred income only. The option to show it as a reduction from the carrying amount of the asset is not permissible under Ind AS.

The FASB proposes amendments to the new revenue standard¹

This article aims to:

- Explain the Financial Accounting Standards Board’s (FASB) proposed amendments to the guidance on licences and identifying performance obligations. It also highlights how the International Accounting Standards Board (IASB) has decided to address these issues in the IFRS version of the standard.



Within a year of publishing their joint standard on revenue recognition, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) are back in their standard setting mode. Changes are intended to address implementation issues referred to the boards by the Transition Resource Group for revenue recognition (TRG). While the FASB’s changes may be more extensive, both boards emphasised that the proposed amendments represent clarifications and are not intended to change the underlying principles.

Following their joint board meeting in February 2015, the FASB has invited constituents to comment on its proposed changes (proposed ASU) to the FASB Accounting Standards Codification, Topic 606, *Revenue from Contracts with Customers* (Topic 606). These proposals are intended to clarify the guidance on accounting for licences of intellectual property (IP) and identifying performance obligations. The IASB has decided to perform additional research and outreach and wait until substantially all of its proposals to the IFRS version of the standard have been discussed, before issuing any exposure draft.

The FASB’s key proposals aim to:

- Clarify how to assess the nature of an IP licence, by classifying the IP as either functional IP or symbolic IP and therefore whether revenue should be recognised over time or at a point in time.
- Clarify that the sales-and-usage based exception applies whenever the licence is the predominate item to which the royalty relates, and that a single royalty stream is not to be split.
- Provide guidance on how contractual restrictions need to be evaluated when determining the performance obligations in a licence arrangement.
- Amend the guidance on identifying performance obligations by re-articulating the principle of ‘separately identifiable’ provided to assess whether a promised good or service is distinct and to add new examples to demonstrate how this is to be applied.
- Add a policy election allowing an entity to consider shipping and handling services, after the transfer of control, as fulfillment costs.

1. Defining Issues 15-21, KPMG in U.S., May 2015

Determining the nature of a licence of IP

ASC Topic 606 provides implementation guidance on whether revenue from a distinct license of IP is recognised over time or as a point in time. To determine whether to recognise revenue over time, an entity considers, *inter alia*, whether it continues to be involved with the IP and undertakes activities

that significantly affect the IP to which the customer has rights. The proposed ASU would amend the implementation guidance on licences of IP to require an entity to classify the IP into either of the following two categories:

Category	Description	Timing of revenue recognition	Examples
Functional intellectual property	<ul style="list-style-type: none"> IP has significant standalone functionality e.g. ability to process a transaction, perform a function or task, or be played or aired. Customer derives a substantial portion of its utility from the IP's standalone utility. 	<ul style="list-style-type: none"> Revenue would generally be recognised at a point in time. If functionality is expected to substantively change as a result of activities of the entity, and the customer is contractually or practically required to use the updated IP, revenue would be recognised over time. 	<ul style="list-style-type: none"> Software Biological compounds or drug formulae Media content (films, television shows, music, etc.).
Symbolic intellectual property	<ul style="list-style-type: none"> IP has no significant standalone functionality. Substantially all of the benefits to the customer is derived from its association with the entity's past or ongoing activities. 	<ul style="list-style-type: none"> Revenue would be recognised over time. 	<ul style="list-style-type: none"> Brands Team or team names Logos Franchise rights.

These amendments respond directly to the concerns expressed by the TRG members, and have the potential to clarify when a revenue from a licence of IP should be recognised over time or at a point in time.

The IASB has favoured a different approach to clarify the guidance. It aims to propose amendments to clarify the criteria whether the contract requires, or the customer reasonably expects, the entity to undertake activities that significantly affect the utility of the IP to which the customer has rights. It believes that utility would be affected when either the entity's activities change the form of the IP or its utility is substantially derived from or dependent on those activities. It will also clarify that an entity's ongoing activities do not significantly affect the utility of the IP when that IP has significant standalone functionalities.

Both boards favour different approaches to clarify the guidance and believe that there should not be a significant difference in practice between the U.S. GAAP and IFRS. However, there is a risk that the use of non-converged language in the U.S. GAAP and IFRS version of the standard could have unintended consequences.

Clarification on applicability of the sales-and-usage based royalty exception

The new revenue recognition standard includes an exception to the general requirement on estimating variable consideration. Under this exception, an entity recognises revenue for a sales-or usage-based royalty of IP at the later of:

- when the subsequent sales or usage occurs
- the performance obligation has been satisfied or partially satisfied.

The proposed amendments clarifies that the above exception applies only if the royalty relates to a licence of IP or if the licence of IP is the predominant item to which the royalty relates. Further, a single royalty stream is not to be split.

The FASB acknowledged that determining when a license is the predominant item would require judgement.

The IASB has also decided to propose amendments on the same lines. These clarifications would help avoid the complexity that would arise for preparers and users if a royalty was accounted for under more than one model, and are therefore consistent with the boards' original rationale for the exception. It would also address the issues raised by stakeholders, promote consistency in application and ease in implementation.

Other licences issues

Contractual restrictions in a licensing arrangements

Questions have been raised by stakeholders about how certain contractual restrictions in a licence affect the entity's identification of its promises in the contract.

The proposed amendments specify that contractual restrictions on time, geography, or a licensee's ability to use or access the underlying IP are attributes of the licence and would not impact the number of performance obligations in the contract. These restrictions define the scope of the licence rather than the number of licenses in the arrangement.

For example, a licence that allows a television station to broadcast a movie on four specific dates during the licence term would be a single performance obligation. However, the proposed ASU also states that some contractual restrictions are not restrictions on the licensee's ability to use or access the IP. For example, if the licensee has the right to use or access the IP for two distinct periods of time, the period

between the licence periods is substantive, and the licensor grants the right to use or access the IP to another party during that intervening period, then the contract might include more than one performance obligation.

When to determine the nature of an IP

The proposed ASU clarifies that when a licence of IP is not distinct from other goods or services in a contract, it may be necessary to determine the nature of the licence to determine whether the performance obligation is satisfied over time or at a point in time. For example, if a licence is bundled with goods or services that are provided over a period shorter than the licence term, an entity would consider the nature and term of the licence when determining the pattern for revenue recognition of the bundled arrangement.

The IASB decided that no standard-setting action is needed in relation to the above issues. This decision would result in non-converged language, with more detailed guidance included in the FASB version of the standard.

Distinct in the context of the contract

An entity is required to account for a promised good or service as a separate performance obligation only if it is distinct i.e. the customer can benefit from it on its own or with other resources that are readily available to the customer (capable of being distinct) and it is separately identifiable (distinct in the context of the contract). While the first criterion is similar to the stand-alone value notion that exists in the current U.S. GAAP, the second criterion is new.

However, in October 2014, the TRG identified that there may be diversity in practice in relation to stakeholders' understanding of what it means for a good or service to be highly dependent on, or highly interrelated with, other goods or services promised in the contract.

The proposed ASU amends the guidance in the context of the contract by:

- Re-articulating the principle of 'separately identifiable' to clarify that the objective when considering whether promised goods or services are separately identifiable is to determine whether the nature of the entity's promise in the contract is to transfer (a) each of those separate goods or services (i.e. several outputs) or (b) a combined item (or items) to which the promised goods or services are inputs.

- Amending the indicative factors with the re-articulated principle to clarify that an entity needs to evaluate whether two promised goods or services each significantly affect the other— not merely whether one is, by its nature, dependent on the other.
- Adding more examples to demonstrate how the separation guidance should be applied.

The IASB decided to only add examples and not to amend other parts of the new standard. Rather, it believed that education of stakeholders and further explanations of the wording that already exists would address the issue. This decision would result in non-converged language between the U.S. GAAP and IFRS version of the standard, with a risk of unintended outcomes.

Other performance obligation issues

Identifying promised goods or services

The first step in identifying performance obligations is to identify the goods or services promised in the contract. The standard states that promised goods or services are not limited to the goods or services explicitly stated in the contract. This may include promises that are implied by an entity's customary business practices, published policies, or specific statements if, at the time of entering into the contract, those promises create a valid expectation of the customer that the entity will transfer a good or service to the customer.

Specific concerns were raised in the U.S. in relation to the boards' decision to not include the U.S. Securities and Exchange Commission (SEC) guidance on inconsequential or perfunctory obligations in the new standard, which would exempt an entity from accounting for performance obligations that are inconsequential or perfunctory.

The proposed ASU specifies that an entity is not required to identify goods or services to be transferred to the customer that are immaterial in the context of the contract. This guidance is an attempt to make implementation of the revenue standard less costly for some preparers.

The IASB decided that no standard-setting action is needed in relation to inconsequential or perfunctory obligations.

Shipping and handling services

Stakeholders have expressed varying views about whether an entity should account for shipping and handling services that occur after the transfer of control of the related goods as a promised service or as a fulfillment cost. Because shipping and handling is not considered a deliverable under the existing U.S. GAAP, a conclusion that shipping and handling is a promised service in some arrangements could be a significant change in practice for some entities.

The proposed ASU introduces a policy election that would allow entities to choose to account for shipping and handling services that occur after the transfer of control of the goods as a fulfillment cost. In either case, the FASB agreed that the cost of shipping and handling that occurs prior to the customer obtaining control of the goods is a fulfillment cost.

The IASB plans to conduct outreach on this issue before it proposes any action.

The boards noted that they do not expect the amendments proposed by the FASB on materiality to create any significant differences in outcomes between IFRS and U.S. GAAP preparers. However, if the IASB decides not to amend IFRS 15 for shipping and handling services, then different outcomes could arise under IFRS and U.S. GAAP.

Effective date

In its meeting on 9 July 2015, the FASB agreed to defer by one year the mandatory effective date of its revenue recognition standard but will also provide entities the option to adopt it as of the original effective date.

For public business entities and certain not-for-profit entities with calendar year-ends, the effective date is 1 January 2018. For non-public entities with calendar year-ends, the effective date is 1 January 2019.

On 22 July 2015, the IASB has also confirmed a one year deferral of the effective date of the revenue recognition standard to 1 January 2018. Companies applying IFRS continue to have the option to apply the standard earlier if they wish to do so.

The effective date and transition requirements for this proposed ASU may be the same as the effective date and transition requirements in Topic 606.

The RBI introduces a strategic debt restructuring scheme as part of restructuring of stressed assets

This article aims to:

- Provide an overview of the strategic debt restructuring scheme introduced by the Reserve Bank of India on 8 June 2015.



Background

On 30 January 2014, the Reserve Bank of India (RBI) released a 'Framework for Revitalising Distressed Assets in the economy' (the Framework) which was effective from 1 April 2014. The Framework lays down guidelines for early recognition of financial distress, taking prompt steps for resolution, and thereby attempting to ensure fair recovery for lending institutions. For operationalising the Framework, the RBI through two notifications dated 26 February 2014, released detailed guidelines on refinancing of project loans, sale of non-performing assets (NPA) by banks and other regulatory measures and on formation of joint lenders' forum (JLF) and adoption of corrective action plan (CAP).

One of the important principles of the detailed guidelines issued by the RBI on 26 February 2014 stipulated that as part of restructuring, shareholders bear the first loss rather than the debt holders. With this principle in view and to ensure more 'skin in the game' of promoters, the RBI issued the following options to be considered by the JLF/CAP cells of the banks to consider the following options when a loan gets restructured:

- Possibility of transferring equity of the company by promoters to the lenders to compensate for their sacrifices
- Promoters infusing more equity into their companies

- Transfer of the promoters' holdings to a security trustee or an escrow arrangement till turnaround of the company. This will enable a change in management control, should lenders favour it.

In order to ensure more stake of promoters in reviving stressed accounts and to provide banks with enhanced capabilities to initiate change of ownership in accounts which fail to achieve the projected viability milestones, banks have been allowed to undertake a Strategic Debt Restructuring (SDR) by converting loan dues to equity shares. The RBI on 8 June 2015 issued a circular which lays down the guidelines for implementing the SDR scheme by banks. Provisions of the SDR would also be applicable to the accounts which have been restructured before the date of this circular.

This article provides an overview of the SDR scheme introduced by the RBI.

Inclusion of conversion option at the time of initial restructuring

- At the time of initial restructuring, the JLF must incorporate terms and conditions of the restructured loans mutually agreed by the borrower, including an option to convert entire loan along with unpaid interest, or part thereof if the borrower is unable to achieve the viability milestones and/adhere to the 'critical conditions' as prescribed in the restructuring package.
- For lenders to exercise conversion option effectively, all necessary approvals/authorisations (including special resolution by the shareholders) from the borrower company or as required under laws/regulations should be obtained at the time of initial restructuring.
- Restructuring of loans without the above approvals/authorisations for SDR is not permitted.

When to initiate SDR mechanism (change in ownership)

- If the borrower is unable to achieve the viability milestones and/or adhere to 'critical conditions' as stipulated in the restructuring package, the JLF should immediately review the account and examine whether the account is viable for effecting SDR mechanism.
- JLF has power to decide whether to invoke the SDR to the entire loan and interest outstanding or part thereof, so as to acquire majority shareholding in the borrower company.
- JLF should take this decision of invoking SDR (conversion of the whole or part of the loan into equity shares) as early as possible but within 30 days from the review of the account (borrower company).

Key guidelines of the SDR mechanism as provided by the RBI

- Decision to invoke SDR mechanism should be well documented and approved by majority of JLF members (minimum 75 per cent of creditors by value and 60 per cent of creditors by number).
- The JLF should approve the SDR conversion package within 90 days from the date of deciding to undertake SDR.
- Lenders under the JLF should collectively become majority shareholders on conversion of their dues from the borrower into equity.
- Such conversion will be subject to the member banks respective of total holdings in shares of the company confirming to the statutory limit in terms of Section 19(2) of the Banking Regulations Act, 1949.
- Post conversion, all lenders under the JLF must collectively hold 51 per cent or more of the equity shares issued by the company.
- Conversion of debt into equity as approved by the JLF must be completed within 90 days from the date of approval of the SDR package by the JLF.
- Post conversion, banks should ensure compliance with Section 6, provisions of the Banking Regulation Act and the JLF should closely monitor performance of the account and appoint professional management to run the affairs of the company.
- The JLF and lenders should divest their holdings in the equity of the company at the earliest.



Guidelines to determine conversion price

- Conversion of debt (principal as well as unpaid interest) into equity should be at 'fair value' which should not exceed the lower of the following two; subject to the floor of 'face value' (restriction under Section 53 of the Companies Act, 2013):
 - i. Market value (for listed companies)- average of the closing prices of the instrument on a recognised stock exchange during the 10 trading days preceding the 'reference date'.
 - ii. Break-up value- book value per share is to be calculated from the company's latest audited balance sheet (should not be more than a year old); without considering 'revaluation reserves', if any and adjusted for cash flows and financials post the earlier restructuring. If the latest balance sheet is not available, this breakup value will be INR1.
- Fair value to be decided at a 'reference date' which is the date of the JLF's decision to undertake SDR.

Asset classification and provisioning

- The invoking of the SDR mechanism would not be treated as restructuring for the purpose of asset classification and provisioning norms.
- The existing asset classification of the account, as on the 'reference date' would continue for a period of 18 months from the 'reference date' post completion of conversion from debt to equity under the SDR mechanism.
- Once bank holdings are divested in favour of a 'new promoter', the account would be considered to be upgraded to a 'standard' category.
- On the date of disinvestment, the provisions made by the bank against this account which should not be less than what was held as the 'reference date' should not be reversed.
- Reversal of provision could be done only when all the outstanding loan/facilities in the account perform satisfactorily during the period specified as per the norms on restructuring of advances.
- In case the bank exits the account completely, the provision may be reversed/absorbed as on the date of exit.



- Asset classification benefit can be availed only if:
 - The new promoter is not a person/entity/subsidiary/associate, etc. (domestic as well as overseas), from the existing promoter/promoter group.
 - New promoter should have acquired at least 51 per cent of the paid-up equity capital of the borrower company.
 - In case promoter is a non-resident, in sectors where ceilings for foreign investment is less than 51 per cent, new promoter should hold higher of:
 - i. at least 26 per cent of paid-up equity, or
 - ii. applicable foreign investment limit.
- Acquisition of shares due to such conversion would be exempted from regulatory ceilings/restrictions on capital market exposures, investment in para-banking activities and intra-group exposure provided:
 - it has been reported to the RBI, and
 - disclosure in the notes to accounts in the annual financial statements has been given by the bank.
- Equity shares acquired and held by banks under the scheme should be exempt from the requirement of periodic mark-to-market (prescribed under prudential norms for classification, valuation and operation of investment portfolio by banks) for a period of 18 months from the 'reference date'.

Exemptions from certain regulations

- Such pricing formula has been exempted from certain prescribed requirements of the Securities and Exchange Board of India (SEBI) (issue of capital and disclosure requirements) Regulations, 2009, subject to certain conditions, in terms of the SEBI (Issue of Capital and Disclosure Requirements) (second amendment) Regulations, 2015.
- In case of listed companies, the acquiring lender has been exempted from the obligation to make an open offer under Regulation 3 (Substantial acquisition of shares or voting rights) and Regulation 4 (Acquisition of control) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

Other matters

- A risk weight of 150 per cent should be assigned to the equity shares acquired for a period of 18 months from the reference date and as per the extant capital adequacy regulations after the expiry of 18 months.
- Conversion by banks may not be treated as an investment in associate.



Enhancing the auditor's report: More insights and transparency

This article aims to:

- Provide an overview of the new requirements on auditor's reporting, issued by the International Auditing and Assurance Standards Board (IAASB).



Enhancing the value of audit¹

For some time, there have been calls from users for the auditor's report to provide more than a pass/fail opinion. In response to these calls, on 15 January 2015, the International Auditing and Assurance Standards Board (IAASB) issued new requirements on auditor reporting.

Without changing the scope of an independent audit, these requirements open the door for the auditor to give users more insights into audit and improve transparency. By clarifying what independent audit really is, the new auditor's report shall help enhance the nature of communication with stakeholders and enable users to recognise the value of audit.

The amendments are effective for audit of financial statements for periods ending on or after 15 December 2016. Therefore, they are applicable for annual financial statements for the year ending 31 December 2016. Early adoption is permitted, however, the entire package of new and revised standards would need to be adopted at the same time. A different effective date or early adoption requirements could be applied in specific jurisdictions, based on local laws or regulations.

Understanding the new requirements

Changes in auditor's report of all entities

An auditor's report issued on complete sets of general purpose financial statements will undergo following changes:

- The report will be reordered, with the audit opinion to be placed first, followed by the basis of opinion.
- Description of responsibility of the management and the auditor will be revised.
- The auditor will provide a statement with respect to work performed over 'other information'.

Introduction of key audit matters

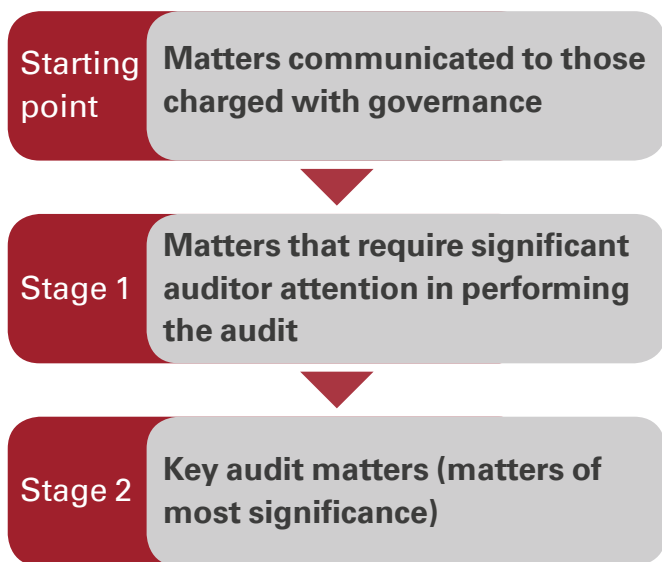
An auditors' report of listed entities would now be required to include:

- Description of key audit matters.
- Disclosure of the name of the engagement partner.

Key audit matters are those matters that, in the auditor's professional judgement, were of most significance in the audit of the financial statements of the current period.

1. International Standards on Auditing (ISA) 700 (Revised), *Forming an opinion and reporting on financial statements* issued by the International Auditing and Assurance Standards Board (IAASB)

Key audit matters are identified as follows:



Starting point: Key audit matters are identified from the matters communicated with those charged with governance.

Stage 1: From the matters communicated to those charged with governance, the auditor identifies matters that require significant auditor attention.

Stage 2: The auditor determines which of the matters identified in Stage 1 were of most significance in the audit of the financial statements. The application of the concept of 'most significance' involves making a judgement about the importance of each matter relative to others in the specific audit. Guidance that will assist in making that judgement is provided in the standard.

The new requirements specify that all matters identified in Stage 1, and the rationale for determining whether each matter is a key audit matter, are to be documented in the audit file.

The auditor is required to communicate matters determined to be key audit matters with those charged with governance and each key audit matter is to be described under an appropriate subheading. The description of each key audit matter identified should include a reference to any related disclosures in the financial statements, and address :

- why the matter was considered to be one of the most significance in the audit, and was therefore determined to be a key audit matter; and
- how the matter was addressed in the audit.

The new requirement do not require the description to include a detailed description of specific procedures performed with respect to the key audit matter or the outcome of audit work undertaken.

Such a description of key audit matters is intended to:

- Enhance the auditor's report by providing greater transparency about the audit that was performed.
- Provide users with additional information to help them understand those matters that, in the auditor's judgement, were of most significance in the audit of the financial statements.
- Help users understand the entity, and the areas of significant management judgement in the financial statements.
- Provide users with a basis to further engage with the management and those charged with governance.

A matter identified as a key audit matter is not disclosed in the auditor's report if:

- Law or regulation precludes public disclosure about the matter, or
- In extremely rare circumstances, the auditor determines that the matter should not be communicated in the auditor's report, because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

In cases where no key audit matters have been determined by the auditor, the auditor is required to:

- Communicate this assessment to those charged with governance.
- Document the rationale for the assessment.
- Disclose the conclusion in the auditor's report.

Going concern as a key audit matter

When events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, and a material uncertainty exists, then such a matter by its nature meets the definition of a key audit matter. However, under the new requirements:

- These types of matters are disclosed in the auditor's report under a separate heading.
- The key audit matters section includes a reference to that other section.

If it is determined that a material uncertainty does not exist, then the matters relating to this conclusion may be considered as a key audit matter. In such circumstances, the description of key audit matters in the auditor's report could include aspects of the identified events or conditions disclosed in the financial statements and related mitigating factors.

To help ensure that such matters are appropriately disclosed in the financial statements, ISA 570, *Going Concern* has been amended to specifically require the auditor to consider whether, in the context of the applicable financial reporting framework, the financial statements provide adequate disclosures when events or conditions that may cast significant doubt on the entity's ability to continue as a going concern have been identified but based on the audit evidence obtained, the auditor concludes that no material uncertainty exists.

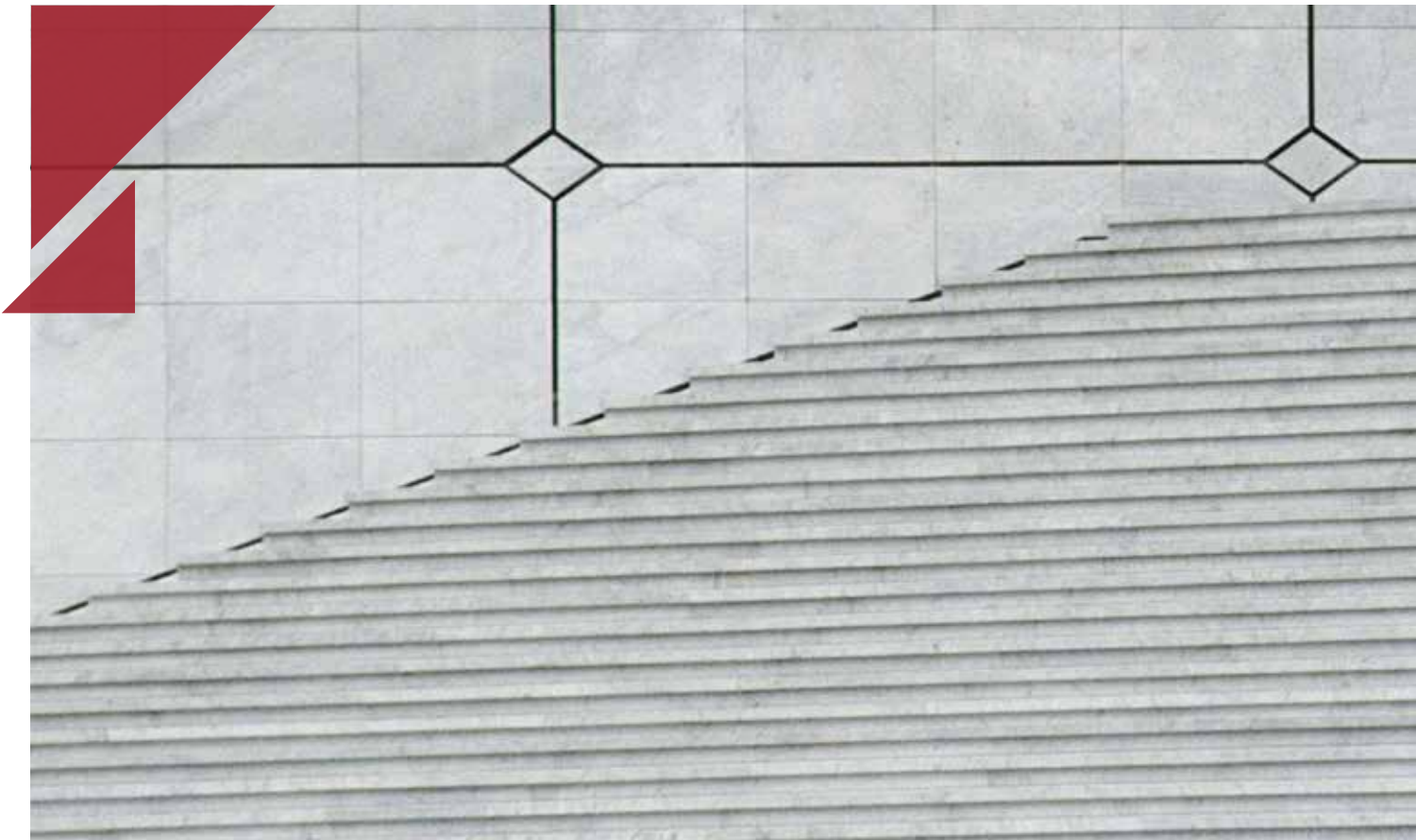
Considerations specific to group audits

The new requirements do not include specific requirements for group audits. ISA 600, *Special Considerations- Audits of Group Financial Statements (including the work of component auditor)*, provides guidance for auditors in performing work on the financial information of a component for a group audit, including those situations where the component auditor does not meet the independence requirements that are relevant to the group audit.

An auditor is prohibited from disclosing key audit matters if the auditor disclaims the opinion to avoid giving credibility to specific items in the financial statements.

Other changes to the auditor's report

- Name of the engagement partner is required to be included in the auditor's report for listed entities. However, if disclosure of the name of the engagement partner is reasonably expected to lead to a significant personal security threat, then the auditor could consider not disclosing the name of the engagement partner in the auditor's report. In such a case, the auditor is required to discuss this intention with those charged with governance, to inform them of the auditor's assessment of the likelihood and severity of the personal security threat.
- The first section of the auditor's report is required to comprise the opinion followed by the basis for that opinion, unless prescribed otherwise by local law or regulation.
- The description of management's responsibilities has been expanded to require a description of when the use of the going concern basis of accounting is appropriate. It has also been expanded with respect to:
 - Assessing the entity's ability to continue as a going concern.
 - Whether the use of the going concern basis of accounting is appropriate.
 - The disclosure of matters relating to going concern, when applicable.



- The description of the auditor's responsibilities has been expanded to include responsibilities with respect to:
 - Concluding on management's use of the going concern basis of accounting.
 - Whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

The new description of the auditor's responsibilities for the audit of the financial statements can be included:

- Within the body of the auditor's report.
- In an appendix to the report, with a reference to the appendix in the main body of the report or
- On a website, with a reference to the website in the report, where law, regulation or national auditing standards expressly permit the auditor to do so.

The auditor's report is required to include a statement that the auditor is independent of the entity in accordance with relevant ethical requirements and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements. The statement identifies the jurisdiction of origin of the relevant ethical requirements or refers to the International Ethical Standards Board for Accountants (IESBA) code.

In a group audit, the reference in the auditor's report to the jurisdiction of origin ordinarily relates to the ethical requirements applicable to the group engagement team as in a group audit, component auditors are subject to the ethical requirements that are relevant to the group audit.

Conclusion

The new reporting requirements are expected to bring more transparency and clarity regarding the auditor's responsibility while performing an audit and regarding the information that they provide to users about the audit. The introduction of key audit matters is the most significant change which would pose great concern for the companies as such matters would be looked upon by the users of the auditor's report at first instance.



Regulatory updates



Requirements specified under the Share Based Employee Benefits Regulations, 2014

The Securities and Exchange Board of India (SEBI) vide circular dated 16 June 2015 has issued necessary guidelines for certain processes/disclosure requirements under the SEBI (Share Based Employee Benefits) Regulations, 2014 notified on 28 October 2014. This, *inter alia*, includes:

- Terms and conditions of schemes to be formulated by the compensation committee.
- Minimum provisions in the trust deed.
- Information required in the statement to be filed with the stock exchange(s).
- Contents of the explanatory statement to the notice and resolution for shareholders' meeting.
- Disclosures by the board of directors.

(Source – Circular CIR/CFD/POLICY CELL/2/2015 by the SEBI dated 16 June 2015)

Clarification on repayment of deposits accepted by the companies before the commencement of the Companies Act, 2013

The Ministry of Corporate Affairs (MCA) vide general circular dated 18 June 2015, issued the following clarifications on repayment of deposits accepted by the companies before the commencement of the Companies Act, 2013 (2013 Act) under Section 74 of the 2013 Act:

- A depositor is free to file an application under Section 73(4), with the Company Law Board (CLB) if the company fails to make repayment of deposits accepted by it.
- The company may also file application under Section 74(2) with the CLB seeking extension of time in making the repayment of deposits accepted by it before the commencement of the provisions of the 2013 Act.
- Explanation to Rule 19 of the Companies (acceptance of deposits) Rules, 2014 clarifies the conditions subject to which a company would be deemed to have complied with the requirements of Section 74(1)(b) of the 2013 Act. Companies can repay deposits accepted prior to 1 April 2014 in accordance with terms and conditions for which the deposits had been accepted.
- There is no bar on the Registrar of Companies for filing of prosecution against a company if such company fails to make repayment of deposits accepted by it under the provisions of the 2013 Act, subject to the above mentioned provision for deposits accepted prior to 1 April 2014.

(Source – Circular 09/2015 by the MCA dated 18 June 2015)

Companies (cost records and audit) (amendment) Rules, 2015

The Ministry of Corporate Affairs (MCA) vide notification dated 12 June 2015, issued the Companies (Cost Records and Audit) (Amendment) Rules, 2015 wherein revised Forms CRA-2 and CRA-4 has been issued. The Rules are effective from the date of their publication in the official gazette.

The MCA has also allowed extension of time for filing of notice of appointment of the cost auditor in the Form CRA-2 for the financial year starting on or after 1 April 2015 till 30 June 2015, and filing of cost audit report to the central government for the financial year 2014-15 in the Form CRA-4 for the financial year starting on or after 1 April 2014 till 31 August 2015.

(Source – Notifications by the MCA dated 12 June 2015)

The SEBI board meeting

The Securities and Exchange Board of India (SEBI) vide press release dated 23 June 2015, issued the minutes of its meeting held on 23 June 2015.

Following are some of the key decisions arrived at the meeting:

1. Streamlining process of public issues - Obviating the need to issue cheques

To increase the reach of retail investors to access the initial public offering (IPO) and reduce the cost of public issues, IPO process has been streamlined to reduce time period for listing of issues from T+12 days to T+6 days. It is expected that due to the streamlining, issuers will have faster access to the capital raised and investors will have early liquidity.

2. Fast track issuances through FPOs or rights issue

The requirement of market capitalisation of public shareholding of the issuer for fast track issues (FTI) has been reduced to INR1,000 crore in case of follow on public offering (FPO) and INR250 crore in case of rights issue subject to compliance with specified conditions. This is expected to help more listed companies to raise further capital using the fast track route.

3. Simplified framework for capital raising by technological start-ups and other companies on institutional trading platform (ITP)

SEBI approved the following proposals to amend the regulations concerning the ITP platform after reviewing the extant regulatory framework in the primary market and taking into account the suggestions of the market participants on making the existing capital avenues for capital raising amenable for accommodating a larger number of start-up companies:

i. The platform should be called as institutional trading platform (ITP) and would facilitate capital raising as well.

ii. The said platform would be made accessible to:

a. Companies which are intensive in their use of technology, information technology, intellectual property, data analytics, bio-technology, nano-technology to provide products, services or business platforms with substantial value addition and with at least 25 per cent of the pre-issue capital being held by Qualified Institutional Buyers (QIBs) (as defined in SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009).

b. Any other company in which at least 50 per cent of the pre-issue capital is held by QIBs.

iii. No person (individually or collectively with persons acting in concert) in such a company would hold 25 per cent or more of the post-issue share capital.

iv. The disclosure should contain only broad objects of the issue and there should be no cap on amount raised for general corporate business. Also, the lock-in of the entire pre-issue capital should be for a period of six months from the date of allotment uniformly for all shareholders.

v. Companies intending to list on the proposed ITP, would be required to file draft offer document with the SEBI for observations, as provided in the SEBI (ICDR) Regulations, 2009.

vi. Following two categories of investors other than retail individual investors can access the proposed ITP:

a. Institutional Investors (QIB as defined in the SEBI (ICDR) Regulations, 2009 along with family trusts, systematically important NBFCs registered with the RBI and the intermediaries registered with the SEBI, all with net-worth of more than INR500 crore).

b. Non-institutional investors (NIIs).

viii. In case of public offer, allotment to institutional investors may be on a discretionary basis whereas to NIIs it shall be on proportionate basis. Allocation between the said two categories should be in the ratio of 75 per cent and 25 per cent, respectively.

ix. In case of discretionary allotment to institutional investors, no institutional investor should be allotted more than 10 per cent of the issue size. All shares allotted on discretionary basis should be locked-in in line with requirements for lock-in by anchor investors i.e. 30 days at present.

x. The minimum application size in case of such issues should be INR10 lakh and the minimum trading lot should be of INR10 lakh.

xi. The number of allottees in case of a public offer should be 200 or more.

- xii. The company would have the option to migrate to main board after three years subject to compliance with eligibility requirements of the stock exchanges.
- xiii. For category I and II alternative investment funds, which are required under the SEBI (Alternative Investment Funds) Regulations, 2012 to invest a certain minimum amount in unlisted securities, investment in shares of companies listed on this platform would be treated as investment in 'unlisted securities' for the purpose of calculation of the investment limits.
- xiv. The existing companies listed on SME-ITP would continue to be guided by the existing regulatory framework including applicable relaxations from compliance with corporate governance requirements.
- xv. In order to rationalise the disclosure requirements for all issuers whether intending to list on the main board or the proposed ITP, it has been decided that the disclosures in offer document with respect to group companies, litigations and creditors should be in accordance with policy on materiality as defined by the issuer. However, all relevant disclosures should be made available on the website of the issuer. Also, the product advertisements of an issuer will not be required to give details of public/rights issue.

(Source – Press release PR No. 167/2015 by the SEBI dated 23 June 2015)

Appointment of non-deposit accepting non-banking finance companies (NBFCs) with asset size of INR100 crore and above as sub-agents under money transfer service schemes (MTSS)

With the view to broaden the network of sub-agents under the money transfer service schemes (MTSS), the Reserve Bank of India (RBI) vide notification dated 12 August 2014, permitted non-deposit accepting NBFCs with asset size of INR100 crore and above to act as sub-agents under MTSS subject to specified conditions. Also, NBFCs desirous to act as sub-agents under the MTSS would have to take prior approval of the RBI.

However, the RBI vide notification dated 25 June 2015, has allowed all non-deposit taking NBFCs to act as sub-agents under MTSS without any prior approval of the RBI. It is to be noted that deposit accepting NBFCs are not permitted to undertake such activity.

(Source – Notifications RBI/2014-15/174 and RBI/2014-15/648 by the RBI dated 12 June 2014 and 25 June 2015)

Applicability of credit concentration norms

As per Section 451A(7)(l) of the Reserve Bank of India Act, 1934, following, *inter alia*, should be deducted while calculating net owned fund (NOF):

- i. Investments of non-banking financial companies (NBFCs) in shares of its subsidiaries and companies in the same group.
- ii. The book value of debentures, bonds, outstanding loans and advances (including hire-purchase and lease finance) made to, and deposits with subsidiaries of NBFCs and companies in the same group

to the extent such amount exceeds 10 per cent of the aggregate of the paid-up equity capital and free reserves as disclosed in the latest balance sheet of the company.

The Reserve Bank of India (RBI) vide notification dated 2 July 2015, decided that in determining concentration of credit/investment, the following should be excluded:

- i. Investments of NBFC in shares of its subsidiaries and companies in the same group.
- ii. The book value of debentures, bonds, outstanding loans and advances (including hire-purchase and lease finance) made to, and deposits with subsidiaries of the NBFC and companies in the same group

to the extent that they have been reduced from owned funds for the calculation of NOF.

(Source – Notification RBI/2015-16/114 by the RBI dated 2 July 2015)

Master circular: Disclosure in financial statements - 'notes to accounts'

The Reserve Bank of India (RBI) vide notification dated 1 July 2015, issued a master circular consolidating all operative instructions issued to banks till 30 June 2015 on matters relating to disclosures in the 'notes to accounts' to the financial statements.

In addition to the instructions consolidated in this master circular, disclosure requirements contained in 'master circular on Basel III capital regulations' will also be applicable.

(Source – Notification RBI/2015-16/99 by the RBI dated 1 July 2015)

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IFRS Notes

The IASB confirms its decision to defer the effective date of the new revenue standard



On 22 July 2015, the International Accounting Standards Board (IASB) confirmed a one year deferral of the effective date of IFRS 15, *Revenue from Contracts with Customers*. Entities

are now required to apply IFRS 15 no later than 1 January 2018. An early adoption continues to be permitted.

The IASB is expected to release its proposed amendments to the new standard shortly. The proposals are expected to relate to licences, identifying performance obligations, principal-agent considerations and transitional provisions.

This decision at the IASB meeting is consistent with that of the Financial Accounting Standards Board (FASB) on 9 July 2015 where it finalised a one year deferral of the new revenue standard.

On 12 May 2015, the FASB issued a proposed ASU, *Identifying Performance Obligations and Licensing*, which would amend FASB ASC Topic 606, *Revenue from Contracts with Customers*, to clarify the guidance about identifying performance obligations and accounting for licences of intellectual property.

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



The MCA extends the last date for filing of annual return and financial statements forms

The Ministry of Corporate Affairs (MCA) has issued a general circular dated 13 July 2015 where it has clarified the following:

- **By 30 September 2015**, the electronic version of the Forms AOC-4, AOC-4 XBRL and MGT-7 will be available for filing.
- **By October 2015**, a separate form for filing of CFS 'AOC-4 CFS' will be made available.
- **Till 31 October 2015**, the Forms AOC-4, AOC-4 XBRL and MGT-7 can be filed with the ROC without payment of additional fees.
- **Till 30 November 2015**, companies to which XBRL is not applicable but are required to file CFS would be able to do so in a separate form for CFS 'AOC-4 CFS' without payment of additional fees.



KPMG in India is pleased to present *Voices on Reporting* – a monthly series of knowledge sharing

calls to discuss current and emerging issues relating to financial reporting

On 22 July 2015, we covered following topics:

- I. Overview of Ind AS 110, *Consolidated Financial Statements* and Ind AS 27, *Separate Financial Statements*
- II. Key differences between AS 21, *Consolidated Financial Statements* and Ind AS 110
- III. Overview of key relaxations for private companies from certain provisions of the Companies Act, 2013.

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