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Ind AS Transition Facilitation Group: Clarifications and Interpretations

Pursuant to the introduction of the Indian Accounting Standards (Ind AS) vide notification dated 16 February 2015, by the Ministry of Corporate Affairs (MCA), companies covered by Ind AS implementation roadmap (corporate roadmap) have already implemented Ind AS on 1 April 2016 or are planning to implement it in the next accounting year. MCA has also notified a separate roadmap for Ind AS implementation for banks, insurance companies and Non-Banking Financial Companies (NBFCs). The date for implementation of Ind AS for these companies is specified in the respective roadmap.

During this transition from accounting standards to Ind AS, most of the companies are facing issues which require immediate clarifications and interpretations.

In order to facilitate smooth implementation process and to overcome the issues faced by these companies, the Accounting Standard Board of the Institute of Chartered Accountants of India (ICAI) constituted the Ind AS Transition Facilitation Group (ITFG) on 11 January 2016 for issuing clarifications on the applicability and interpretations under Companies (Indian Accounting Standards) Rules, 2015.

The ITFG has conducted six meetings till date and it has issued six bulletins to provide clarifications and interpretations on matters which are being raised before it by preparers and users of financial statements and other stakeholders.

In this month's issue, we cover a brief update on several clarifications/interpretations issued by the ITFG in all its six bulletins. We discuss following issues:

- Applicability
- Net worth criteria
- Property, Plant & Equipment (PPE)
- Deemed cost exemption
- Presentation of financial statements
- Foreign currency
- Operating lease
- Separate financial statements
- Financial liabilities
- Service Concession Arrangements
- Conclusion

Applicability

Foreign companies

As foreign companies are not required to prepare financial statements based on Ind AS, the net worth of a foreign company with a subsidiary in India is not the basis for deciding whether its Indian subsidiary company is required to prepare financial statements based on Ind AS. The stand alone net worth of such Indian subsidiary company will be considered for applicability of Ind AS.

NBFCs

- NBFCs are required to follow a separate Ind AS roadmap as issued by the Reserve Bank of India (RBI) and are required to prepare their first Ind AS financial statements on or after 1 April 2018. Subsidiaries, associates or joint ventures of such NBFCs shall prepare their stand alone financial statements as per Ind AS if they meet the applicability criteria as defined in the corporate roadmap. However, for the purpose of consolidation, such subsidiaries, associates or joint ventures shall be required to provide the relevant financial statement information in accordance with the accounting policies followed by the parent NBFC i.e. as per the Accounting Standards notified by MCA.

In cases where the NBFC itself is a subsidiary, associate or joint venture of a company which is required to follow the corporate roadmap, the parent company will prepare the consolidated financial statements as per Ind AS and the NBFC is required to provide relevant financial statement information for the purpose of consolidation as per Ind AS.

- In case of any exemption given by the RBI to a certain class of NBFCs (Core investment companies) from its regulation, such NBFCs will still be governed by the roadmap specified for NBFCs.

Holding, subsidiary, associate and joint ventures

- If a company is required to implement Ind AS either mandatorily or does it voluntarily, then its holding, subsidiary, associate and joint venture companies are also required to comply with the Ind AS. Key points of the same are:
    - The relationship between the parent company and its subsidiary, associate or joint venture should exist at the beginning of the financial year in which the company prepares its first Ind AS financial statements.
    - If the relationship ceases to exist after the beginning of the financial year as mentioned above, the holding, subsidiary, associate or joint venture company still needs to prepare the financial statements as per Ind AS.
    - For the purpose of applicability, all relationships, whether direct or indirect, shall be covered. For example, if entity A has control over entity B and entity B have control over entity C, then entity A is said to be ultimate holding company of entity C and all these entities are required to follow Ind AS.
- If a company is required to follow Ind AS under the corporate roadmap and the company acquire the shares of one or more companies before the end of the year of its first Ind AS financial statement and as a result of the acquisition, the acquiring company obtains control or significant influence, making the acquiree company its subsidiary, associate or joint venture, then all such companies shall also prepare their financial statements as per Ind AS.

  If the acquirer company is required to present quarterly financial statements then it shall also consolidate financial statements of all its subsidiary, associate or joint venture companies which have been acquired during the year.

- Relationship between the parent company and its subsidiary, associate or joint venture are determined as per Ind AS irrespective of the fact that whether it was a subsidiary, associate or joint venture under the previous Indian GAAP or not. For example, if any particular company is an associate of another company under the previous GAAP and ceases to be an associate on application of Ind AS, then such associate need not apply Ind AS except when it meets the net worth criteria.

Others

- Any listed company which is not covered by phase I of Ind AS implementation roadmap and gets delisted before 1 April 2017 will not be required to implement Ind AS from year 2017-18 unless the company meets the net worth criteria of INR 2.5 billion.
- If companies covered under section 8 of Companies Act, 2013 meet the applicability criteria, they have to prepare financial statements as per Ind AS. These companies are not exempted from the provisions of section 133 and 129 of the Companies Act, 2013.

Net worth criteria

- The net worth threshold criteria figures specified in corporate roadmap should always be positive. Companies with negative net worth will be outside the scope of Ind AS applicability unless it is a listed company and continues to be listed till 31 March 2017.
- Companies meeting the threshold criteria of corporate roadmap for the first time after 1 April 2016 shall apply Ind AS from immediately following accounting year.
- The net worth shall be calculated in accordance with the stand-alone financial statements of the company as on 31 March 2014. Accordingly, if the net worth threshold criteria for a company is once met, then it shall implement Ind AS, irrespective of the fact that as on a later date its net worth falls below the criteria specified.
- Capital reserve in the nature of promoter's contribution is a capital contribution by promoters and it should be included in net worth calculation. AS 12 Accounting for Government Grant states that government grant in the nature of promotors contribution are recognised in the shareholders fund even if it was not created out of the profits of the company. Accordingly, it will be included in the calculation of net worth for determination of Ind AS applicability. However, the same analogy cannot be applied for determination of net worth under other provisions of the Companies Act, 2013.

Property, Plant & Equipment (PPE)

- As per Ind AS 16, if spare parts meet the definition and recognition criteria of a PPE, then it shall be separately accounted from its original asset. If such definition and recognition criteria are not met, then such spare parts are required to be accounted as Inventory.

- The depreciation on items of spare parts will begin when the asset is available for use, i.e. when it was made available at the location and in the condition necessary for it to be useable in the manner intended by the management.
- In cases where the spare part is readily available for use, it may be depreciated from the date of purchase. In determination of the useful life of the spare part, the life of the machine can be one of the determining factors.
- Ind AS 16 allows capitalisation of expenditure incurred on the construction of assets on a land not owned by the company. The capitalisation of such expenditure would depend on the facts and circumstances of each case, particularly the fact whether such expenditure is necessary for making the item of PPE capable of operations in the manner intended by the management.
- While transitioning to Ind AS, a first-time adopter's estimate of depreciation under the previous GAAP can only be changed if those estimates were incorrect. However, when a company has been computing depreciation as per rates prescribed under schedule XIV of the Companies Act, 1956, then it has not estimated the useful life of an asset but has depreciated its assets as per the minimum requirements of law.
- In case such company chooses to measure its PPE by retrospective application of Ind AS 16, it will have to re-compute depreciation by assessing the useful life of an asset in accordance with Ind AS 16 which is consistent with schedule II of the Companies Act, 2013.

Deemed cost exemption

As per para D7AA of Ind AS 101, where there is no change in the functional currency, the existing GAAP carrying values on the date of transition shall be considered as deemed cost.

The ITFG has given few clarifications in relation to this exemption:

- The ITFG clarified that the condition of deemed cost optional exemption doesn't prevent a company to recognise any spare parts as PPE whose recognition is required under Ind AS 16. On the date of transition if any such spare parts meet the definition of PPE provided under Ind AS 16 then it shall be included in carrying value of PPE and previous GAAP carrying values of such spare parts shall be considered as deemed cost.
- The exemption should be applied to all the PPE. In other words, selective application of exemption is not permitted.
- In case the company has obtained a loan which is measured at amortised cost, for the acquisition of PPE and the company has availed the deemed cost exemption, the impact shall be as follows:
  - PPE shall continue to be valued at previous GAAP values
  - The impact of measuring the financial liability (i.e. loan) at amortised cost will be given in retained earnings.
  - Capital work in progress is in the nature of PPE under construction and accordingly, provisions of Ind AS 16 shall apply to it. Similarly, deemed cost optional exemption is also available for capital work in progress, provided there will not be any change in the functional currency.
- Adjustments in respect of retrospective application of Ind AS 20 - Accounting for Government Grants and Government Assistance shall be recognised in retained earnings and PPE shall continue to be valued at previous GAAP values.

Presentation of financial statements

- Companies who have adopted Ind AS voluntarily from the year 2015-16 or thereafter are required to prepare their financial statements as per the format specified under Division II of the revised schedule III.
- All the companies covered under phase I of Ind AS are compulsorily required to prepare their transitional balance sheet as on 1 April 2015. Such companies cannot have a different date of transition, that they may be required to follow under a different GAAP adopted by them, like International Financial Reporting Standards (IFRS).
- Ind AS 18 does not prescribe any specific guidance for presentation of excise duty. Revenue is the gross inflows of economic benefits received by a company on its own account. When a company acts as an agent of the government by the way of collection of taxes/duties which are pass-through in nature, then such taxes/duties will be excluded from revenue.
- The ITFG clarified that excise duty is levied on manufacturing, irrespective of the fact that whether the goods manufactured are sold or not. Accordingly, it should be included in the statement of profit and loss prepared under Ind AS. Correspondingly, excise duty paid/payable to the government should be presented as an expense.
- Other indirect taxes like sales tax, service tax, etc. represent the amount collected on the behalf of a third party and the same is pass-through in nature. Accordingly, it should not be considered as a part of revenue.
- If an entity does not have an unconditional right to defer the settlement of a liability, then the same shall be classified as current liability.

Electricity companies must classify security deposits collected from customers as current liability, even though it is expected that most of the customers will not surrender their connection and there is no need to refund the deposit but surrendering of a connection is a condition that is not within the control of the entity.

Accordingly, the electricity company does not have a right to defer the refund of deposit. Even if the company expects that it will not be settled within 12 months, it is not relevant to classify the liability as a non-current liability. Accordingly, security deposits should be classified as a current liability in the books of the electricity company.

- If a financial instrument is classified as debt, the dividend (for example, redeemable preference shares) paid thereon is in the nature of interest and accordingly shall be charged to profit or loss.
- Dividend or interest paid on a financial instrument which is classified as equity (for example, equity shares/fully convertible debentures, etc.), should be recognised in the statement of changes in equity.

  In case of a compound financial instrument, the dividend or interest allocated to debt component shall be charged to profit or loss and the portion of dividend or interest pertaining to equity component shall be recognised in statement of changes in equity.

  Dividend Distribution Tax (DDT) should be charged to profit or loss or to the statement of changes in equity depending on where the underlying dividend is presented.

Foreign Currency

- The assessment of functional currency has to be done at an entity level. Accordingly, if an entity identifies one currency as functional currency for one business/division and another currency as functional currency for another business/division, it needs to evaluate primary economic environment in which whole entity operates and assess its functional currency.
- Ind AS 21 is silent on whether such assessment should be from the date of transition or retrospectively. The ITFG clarified that since neither any exception nor exemption has been specified for such assessment, an entity will have to make an assessment retrospectively.
- As per para 46/46A of AS 11, the company has an option to:
  - Capitalise foreign exchange gain/loss on long-term foreign currency monetary items in case of depreciable assets
  - Accumulate the gain/loss in foreign currency monetary items translation difference account (FCMITDA) in case of non-depreciable assets.
- As per para D13AA of Ind AS 101, company may continue the policy adopted for accounting for exchange differences arising from translation of long-term foreign currency monetary items recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP. The ITFG has issued following clarifications in respect of the above exemption:
  - The exemption can be utilised only for the items which are obtained before the date of transition. For items obtained after the date of transition, Ind AS 109 shall be applicable and accordingly the exemption will be not be available.
  - If the company opts to continue such policy, the company shall route such balance through profit or loss and not through Other Comprehensive Income (OCI).
  - The company cannot continue such policy if foreign currency becomes functional currency by virtue of Ind AS 21.
  - In case of non depreciable assets, if the company has opted to recognise financial liability at amortised cost, the balance in FCMITDA will have to be revised based on the amortised cost of the loan.
  - In case the company has hedged its foreign currency exposure for a foreign currency long term monetary item and the company is taking the exemption given under para D13AA, it can no longer follow hedge accounting for such derivatives.

Operating Lease

As per Ind AS 17, lease payments shall be straight-lined over the period of lease unless such payments to the lessor are structured to increase in line with expected general inflation to compensate for the lessor's expected inflationary cost. If payments to the lessor vary because of factors other than general inflation, then lease payments shall be straight-lined.

It is not necessary that the rate of the escalation of lease payments should be equal to the expected general inflation. If the actual increase or decrease in the rate of inflation is not materially different as compared to the expected rate of inflation under the lease agreement, the lessee is not required to straight-line the lease payments. However, the purpose of such escalation should only be to compensate the lessor for the expected general inflation rate.

Separate financial statements

- As per para D15 of Ind AS 101, a company has an exemption to consider fair value of its investments in subsidiary, associates or joint ventures as deemed cost.

  The ITFG clarified that since fair value is deemed to be cost of such investment for the company, it shall carry its investment at that amount (i.e. fair value on the date of transition) after date of transition.

  If any company has joint control over the other company and has assessed such investment as joint venture, then such joint control should be measured at cost or in accordance with Ind AS 109. Profit from such joint venture shall be recognised as income in the statement of profit and loss as and when rights to receive such profits have been established. Accounting for returns from such investment will also depend on contracts between the parties.

Financial Liabilities

When a company has utilised Securities Premium Account (under section 78 of Companies Act, 1956) for liability payable on redemption of non-convertible debentures at premium, question arises whether a company is required to make any retrospective accounting adjustment in the books while transitioning to Ind AS.

As per Ind AS 109, most of the financial liabilities of a company are measured at amortised cost unless they are designated as at Fair Value Through Profit or Loss (FVTPL).

The ITFG has clarified that when a company designates any non-convertible debentures as at FVTPL, it shall determine the fair value of such debentures as on the date of transition and any difference between the carrying amount as per the previous GAAP and fair value shall be adjusted in retained earnings on the date of transition. Therefore, no retrospective accounting adjustments are required to be made in the books.

However, when such debentures are measured at amortised cost, the company is required to calculate Effective Interest Rate (EIR) retrospectively on the date of issue of such debentures and is required to compute the amortised cost on the date of transition. As on the date of transition, the difference between such amortised cost and carrying amount under the previous GAAP is required to be adjusted in the books and the company should credit Securities Premium Account to the extent it was utilised for liability towards premium payable on redemption of debentures with a corresponding debit to the account which was credited earlier.

Service Concession Arrangements

Paragraph 7AA of Ind AS 38 read with paragraph D22 of Ind AS 101, specifically allows revenue based amortisation of intangible assets for service concession arrangements in respect of toll roads recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS reporting period. Such revenue based amortisation method is not allowed for intangible assets relating to toll roads that are recognised after the date of transition to Ind AS. However, Schedule II of the Companies Act, 2013 allows revenue based amortisation for all such road projects even after the date of transition to Ind AS. These results in conflict between treatments given in Ind AS 38 read with paragraph D22 of Ind AS 101 and Schedule II of Companies Act, 2013.

In order to harmonise Companies (Accounts) Rules, 2014 and Ind AS 38 read with paragraph D22 of Ind AS 101, the ITFG has clarified that principles of Ind AS 38 should be followed for all new service concession arrangements including toll roads entered into after Ind AS becomes applicable.

Conclusion

In this issue, we have covered clarifications and interpretations provided by the ITFG to companies who have implemented Ind AS from the FY 2016-17. Moving forward as other class/classes of companies get covered under the Ind AS roadmap, further issues may be raised before the ITFG. All such clarifications and interpretations would be helpful to all companies in following consistent principles while transitioning to Ind AS. Such subsequent clarifications and interpretations will be dealt with in our coming issues of Connect the GAAP.

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