Ind AS Transition Facilitation Group (ITFG) Clarification Bulletin 2

The Accounting Standards Board (ASB) of the ICAI has constituted 'Ind AS Transition Facilitation Group' (ITFG)[1] for providing clarifications on timely basis on various issues related to the applicability and /or implementation of Ind AS under the Companies (Indian Accounting Standards) Rules, 2015, raised by preparers, users and other stakeholders.

At the Second (2nd) Ind AS Transition Facilitation Group (ITFG) meeting held on April 12, 2016 at New Delhi, issues received from some members were discussed. The Group after due deliberations decided to issue following clarifications[2] on the issues considered at the meeting.

Issue 1. Y Ltd. is a first time adopter of Ind AS. The date of transition is April 1, 2015. On April 1, 2010, it obtained a 7 year US$ 1,00,000 loan. It has been exercising the option provided in Paragraph 46/46A of AS 11 and has been amortising the exchange differences in respect of this loan over the balance period of such loan. On the date of transition, the company intends to continue the same accounting policy with regard to amortising of exchange differences. Whether the Company is permitted to do so? Whether amortisation of balance of Foreign Currency Monetary Item Translation Difference Account (FCMITDA) be routed through profit or loss or through Other Comprehensive Income (OCI).

Response: Ind AS 101 includes an optional exemption to continue the existing policy as per the previous GAAP, i.e., existing AS 11 in respect of the 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.

Paragraph D13AA of Ind AS 101 provides that a first-time adopter 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. Therefore, if an entity opts to follow the aforesaid paragraph of Ind AS 101, it has to continue to apply the accounting policy followed for such long-term foreign currency monetary item.

In view of the above, Company Y can continue to follow the existing accounting policy of amortising the exchange differences in respect of this loan over the balance period of such long term liability.

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[1] Announcement on the Constitution of Ind AS Transition Facilitation Group (ITFG) is available at the ICAI's website at http://www.icai.org/new_post.html?post_id=12289&c_id=219

[2] *Although the 'Ind AS Transition Facilitation Group' (ITFG) has been constituted by the Accounting Standards Board (ASB), clarifications given or views expressed by the ITFG represent the views of the members of the Ind AS Transition Facilitation Group (ITFG) and are not necessarily the views of the ASB or the Council of the Institute. The clarifications/views are based on the accounting principles as on the date the Group finalises the particular clarification. The date of finalisation of each clarification is indicated along with the clarification. The clarification must, therefore, be read in the light of any amendments and/or other developments subsequent to the issuance of clarifications by the Group.*

Since the amortisation of exchange differences under the existing policy as per the previous GAAP would be to recognise periodic amortised amount in the statement of profit and loss affecting the profit or loss for the period, amortisation of balance of Foreign Currency Monetary Item Translation Difference Account (FCMITDA) shall be routed through profit or loss and not through Other Comprehensive Income (OCI).

Issue 2. Applicability of Ind AS to an Indian subsidiary of a foreign company

Company X Ltd. and Company Y Ltd. registered in India having net worth of Rs 600 crores and 100 crores respectively are subsidiaries of a Foreign Company viz., ABC Inc., which has net worth of more than Rs. 500 crores in financial year 2015-16. Whether Company X Ltd. and Y Ltd. are required to comply with Ind AS from financial year 2016-17 on the basis of net worth of the parent Foreign Company or on the basis of their own net worth?

Response: Rule 4(1)(ii)(a) of the Companies (Indian Accounting Standards) Rules, 2015, states as under:

"*The Companies and their auditors shall comply with the Indian Accounting Standards (Ind AS) specified in Annexure to these rules in preparation of their financial statements and audit respectively, in the following manner, namely:-*

(i) any company may comply with the Indian Accounting Standards (Ind AS) for financial statements for accounting periods beginning on or after 1st April, 2015, with the comparatives for the periods ending on 31st March, 2015, or thereafter;

(ii) the following companies shall comply with the Indian Accounting Standards (Ind AS) for the accounting periods beginning on or after 1st April, 2016, with the comparatives for the periods ending on 31st March, 2016, or thereafter, namely:-

(a) companies whose equity or debt securities are listed or are in the process of being listed on any stock exchange in India or outside India and having net worth of rupees five hundred crore or more;"

As per Rule 4(1)(ii)(a) of the Companies (Indian Accounting Standards) Rules, 2015, Company X having net worth of Rs.600 crores in the year 2015-16, would be required to prepare its financial statements for the accounting periods commencing from 1st April, 2016, as per the Companies (Indian Accounting Standards) Rules, 2015.

Company Y Ltd. having net worth of Rs.100 crores in the year 2015-16, would be required to prepare its financial statements as per the Companies (Accounting Standards) Rules, 2006.

Since, the Foreign company ABC Inc., is not a company incorporated under the Companies Act, 2013 or the earlier Companies Act, 1956, it is not required to prepare its financial statements as per the Companies (Indian Accounting Standards) Rules, 2015.As the foreign company is not required to prepare financial statements based on Ind AS, the net worth of foreign company ABC would not be the basis for deciding whether Indian Subsidiary Company X Ltd. and Company Y Ltd. are required to prepare financial statements based on Ind AS.

Issue 3. Company X Ltd. has prepared its financial statements under IFRS for the first time for year ended March 31, 2016. It had adopted its date of transition to IFRS as

April 1, 2014. As per the Companies (Indian Accounting Standards) Rules, 2015, Company X Ltd. is mandatorily required to prepare its financial statements as per Ind AS for the year ended March 31, 2017 and hence under Ind AS, the date of transition would be April 1, 2015.

Whether Company X Ltd. can select date of transition under Ind AS as April 1, 2014 instead of April 1, 2015 since it has already carried out exercise of transition on April 1, 2014 for the purposes of IFRS.

Response: Appendix A to Ind AS 101, *First- time Adoption of Indian Accounting Standards,* defines date of transition as follows:
"The beginning of the earliest period for which an entity presents full comparative information under Ind ASs in first Ind AS financial statements"

The definition of date of transition as stated above therefore permits an entity to select its date of transition. However, Rule 4(1)(i) and (ii) of the Companies (Indian Accounting Standards) Rules, 2015, states as under:

"The Companies and their auditors shall comply with the Indian Accounting Standards (Ind AS) specified in Annexure to these rules in preparation of their financial statements and audit respectively, in the following manner, namely:-

(i) any company may comply with the Indian Accounting Standards (Ind AS) for financial statements for accounting periods beginning on or after 1st April, 2015, with the comparatives for the periods ending on 31st March, 2015, or thereafter;

(ii) *the following companies shall comply with the Indian Accounting Standards (Ind AS) for the accounting periods beginning on or after 1st April, 2016, with the comparatives for the periods ending on 31st March, 2016, or thereafter, namely…".*

As per the above rule, the date of transition for X Ltd. will be April 1, 2015 being the beginning of the earliest comparative period presented. To explain it further, X Ltd. is required to mandatorily adopt Ind AS from April 1, 2016, i.e for the period 2016-17, and it will give comparatives as per Ind AS for 2015-16. Accordingly, the beginning of the comparative period will be April 1, 2015 which will be considered as the date of transition as per Ind AS.

Although Company X Ltd. has already carried out exercise of transition on April 1, 2014 for the purposes of IFRS, Company X Ltd. cannot select date of transition under Ind AS as April 1, 2014.

Issue 4. A Company has a spare part, which it terms as 'insurance spare', is required to be used along with equipment. Whether the spare part is required to be recognised as part of that equipment? Whether depreciation is required to be calculated separately for that spare part or along with the equipment for which it has been used?

Response: As per paragraph 8 of Ind AS 16, *Property, Plant and Equipment*, items such as spare parts are to be recognised in accordance with Ind AS 16, when they meet the definition of 'property, plant and equipment'. Otherwise such items are classified as inventory.

As per Ind AS 16, 'property, plant and equipment', are tangible items that:

(a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and

(b) are expected to be used during more than one period.

Paragraph 7 of Ind AS 16, *Property, Plant and Equipment,* states as under:

> The cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:
>
> (a) it is probable that future economic benefits associated with the item will flow to the entity; and
>
> (b) the cost of the item can be measured reliably.

Therefore, if an item of spare part meets the definition of 'property, plant and equipment' as mentioned above and satisfies the recognition criteria as per paragraph 7 of Ind AS 16, such an item of spare part has to be recognised as property, plant and equipment separately from the equipment. If that spare part does not meet the definition and recognition criteria as cited above that spare part is to be recognised as inventory.

The depreciation on such an item of spare part will begin when the asset is available for use i.e when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. In case of a spare part, as it may be readily available for use, it may be depreciated from the date of purchase of the spare part. In determination of the useful life of the spare part, the life of the machine in respect of which it can be used can be one of the determining factors.

Issue 5. Company X has incurred expenditure on construction of a road on the land which is not owned by the Company. Whether the expenditure incurred on construction of such a road by the Company has to be capitalised or expensed out under Ind AS?

Response: The capitalisation of expenditure incurred on construction of assets on land not owned by a company would depend on facts and circumstances of each case, particularly, considering paragraph 16(b) of Ind AS 16, *Property, Plant and Equipment (PPE),* which states that such an expenditure should be necessary for making the item of PPE capable of operating in the manner intended by the management.

Issue 6. A Company has opted for the accounting treatment under paragraph 46A of AS 11, *The Effects of Changes in Foreign Exchange Rates*, under the Companies (Accounting Standards) Rules, 2006, in respect of purchase of other than depreciable assets and accordingly, exchange difference on account of long term foreign currency loans is accumulated and amortised over the balance period of such loan. The company has taken a long term loan of Rs. 1000 crores and incurred upfront / processing fee of Rs. 40 crores. Under the Companies (Accounting Standards) Rules, 2006, Rs. 40 crores had been charged off as finance cost in the statement of profit and loss in the year of loan and Rs.1000 crores is carried as long term loan. The loan which is outstanding on the balance sheet date (for simplicity it is assumed that repayment of loan has not yet started) is translated at the rate of exchange prevailing at the date of balance sheet and the exchange difference is parked in Foreign Currency Monetary Item Translation Difference Account (FCMITDA), which is being amortised over the term of loan.

Under the Companies (Indian Accounting Standards) Rules, 2015, on the date of transition, the effective rate of interest will be worked out based on the net inflow of loan amount i.e. Rs. 960 crores in this case.

Whether the balance of FCMITDA based on loan inflow of Rs. 960 crores or Rs. 1000 crores be continued as per Ind AS on date of transition as per the Paragraph D13AA of Ind AS 101, *First time Adoption of Indian Accounting Standards*.

Response: As per paragraph D13AA of Ind AS 101, *First time Adoption of Indian Accounting Standards*:"

"A first-time adopter 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".

Long term loan taken by Company is a financial liability under Ind AS 109, *Financial Instruments*. Paragraphs 4.2.1 and 4.2.2 of Ind AS 109 provide for classification and subsequent measurement of financial liability as follows:

"4.2.1 An entity shall classify all financial liabilities as subsequently measured at amortised cost, except for:

(a) financial liabilities at fair value through profit or loss. Such liabilities, including derivatives that are liabilities, shall be subsequently measured at fair value.

(b) financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or when the continuing involvement approach applies. Paragraphs 3.2.15 and 3.2.17 apply to the measurement of such financial liabilities.

(c) financial guarantee contracts. After initial recognition, an issuer of such a contract shall (unless paragraph 4.2.1(a) or (b) applies) subsequently measure it at the higher of:

(i) the amount of the loss allowance determined in accordance with Section 5.5 and
(ii) the amount initially recognised (see paragraph 5.1.1) less, when appropriate, the cumulative amount of income recognised in accordance with the principles of Ind AS18.

(d) commitments to provide a loan at a below-market interest rate. An issuer of such a commitment shall (unless paragraph 4.2.1(a) applies) subsequently measure it at the higher of:

(i) the amount of the loss allowance determined in accordance with Section 5.5 and
(ii) the amount initially recognised (see paragraph 5.1.1) less, when appropriate, the cumulative amount of income recognised in accordance with the principles of Ind AS18.

(e) contingent consideration recognised by an acquirer in a business combination to which Ind AS103 applies. Such contingent consideration shall subsequently be measured at fair value with changes recognised in profit or loss.

Option to designate a financial liability at fair value through profit or loss

4.2.2 An entity may, at initial recognition, irrevocably designate a financial liability as measured at fair value through profit or loss when permitted by paragraph 4.3.5, or when doing so results in more relevant information, because either:

(a) it eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as 'an accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases (see paragraphs B4.1.29– B4.1.32); or

(b) a group of financial liabilities or financial assets and financial liabilities is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel (as defined in Ind AS 24 Related Party Disclosures), for example, the entity's board of directors and chief executive officer (see paragraphs B4.1.33–B4.1.36)".

In view of the above, the first time adopter needs to revise the balance of FCMITDA based on the loan at amortised cost of Rs. 960 crores retrospectively if the loan is not designated as at fair value through profit or loss (FVTPL) .

Issue 7. Company ABC Ltd. had issued non-convertible debentures redeemable at premium, which were outstanding as on March 31, 2015.Upon issuance of the debentures, company ABC Ltd. had utilised the Securities Premium Account for the entire redemption premium which it felt was in line with the requirements of section 78 of the Companies Act, 1956.

As the entire liability towards premium had been utilised, whether any retrospective accounting adjustments are required to be done in the books under Ind AS.

Response: Non- convertible debentures issued by Company ABC Ltd. is a financial liability under Ind AS 109, *Financial Instruments*. Paragraphs 4.2.1 and 4.2.2 of Ind AS 109 provide for classification and subsequent measurement of financial liability as follows:

"4.2.1 An entity shall classify all financial liabilities as subsequently measured at amortised cost, except for:

(a) financial liabilities at fair value through profit or loss. Such liabilities, including derivatives that are liabilities, shall be subsequently measured at fair value.

(b) financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or when the continuing involvement approach applies. Paragraphs 3.2.15 and 3.2.17 apply to the measurement of such financial liabilities.

(c) financial guarantee contracts. After initial recognition, an issuer of such a

contract shall (unless paragraph 4.2.1(a) or (b) applies) subsequently measure it at the higher of:

(i) the amount of the loss allowance determined in accordance with Section 5.5 and
(ii) the amount initially recognised (see paragraph 5.1.1) less, when appropriate, the cumulative amount of income recognised in accordance with the principles of Ind AS18.

(d) commitments to provide a loan at a below-market interest rate. An issuer of such a commitment shall (unless paragraph 4.2.1(a) applies) subsequently measure it at the higher of:

(i) the amount of the loss allowance determined in accordance with Section 5.5 and
(ii) the amount initially recognised (see paragraph 5.1.1) less, when appropriate, the cumulative amount of income recognised in accordance with the principles of Ind AS18.

(e) contingent consideration recognised by an acquirer in a business combination to which Ind AS103 applies. Such contingent consideration shall subsequently be measured at fair value with changes recognised in profit or loss.

Option to designate a financial liability at fair value through profit or loss

4.2.2 An entity may, at initial recognition, irrevocably designate a financial liability as measured at fair value through profit or loss when permitted by paragraph 4.3.5, or when doing so results in more relevant information, because either:

(a) it eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as 'an accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases (see paragraphs B4.1.29– B4.1.32); or

(b) a group of financial liabilities or financial assets and financial liabilities is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel (as defined in Ind AS 24 Related Party Disclosures), for example, the entity's board of directors and chief executive officer (see paragraphs B4.1.33–B4.1.36)".

In view of the above, if the non-convertible debentures are not designated as at fair value through profit or loss (FVTPL) they shall be subsequently measured at amortised cost.

In case Company ABC Ltd. designates the debentures as at FVTPL the company shall determine the fair value of liability as on the date of transition and any difference between the carrying amount and the so determined fair value shall be recognised in retained earnings. Therefore, in such a case no retrospective adjustments are required to be made in the books. However, if the debenture is measured at amortised cost, Company ABC Ltd. will have to retrospectively calculate Effective Interest Rate (EIR) as on the date of issue of debenture and arrive at the amortised cost at the date of transition.