WIRC of ICAI

Speaker : Sumit Seth

Virtual CPE meeting

Ind AS - General Purpose Financial Statements- practical insights

Ind AS 116, Leases
Ind AS 101, First-time Adoption
Ind AS 34, Interim Financial Reporting
Ind AS 21, The Effects of Changes in Foreign Exchange Rates
Ind AS 23, Borrowing Costs
Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets
Ind AS 102, Share based Payment
Ind AS 108, Operating Segments
Ind AS 1, Presentation of Financial Statements
Ind AS 24, Related Party Disclosures

Ind AS 116 Leases

Entity X enters into a contract with Entity Y for a period of five years for the use of a particular aircraft which is explicitly specified in the contract. The contract details the interior and exterior specifications for the aircraft. It also contains contractual and legal restrictions on where the aircraft can fly.

Subject to these restrictions, Entity X decides whether, where and when and for what purpose (i.e., to carry passengers or cargo) the aircraft will fly. Entity Y operates and maintains the aircraft using its own crew.
Whether Entity X has right to control the use the aircraft?

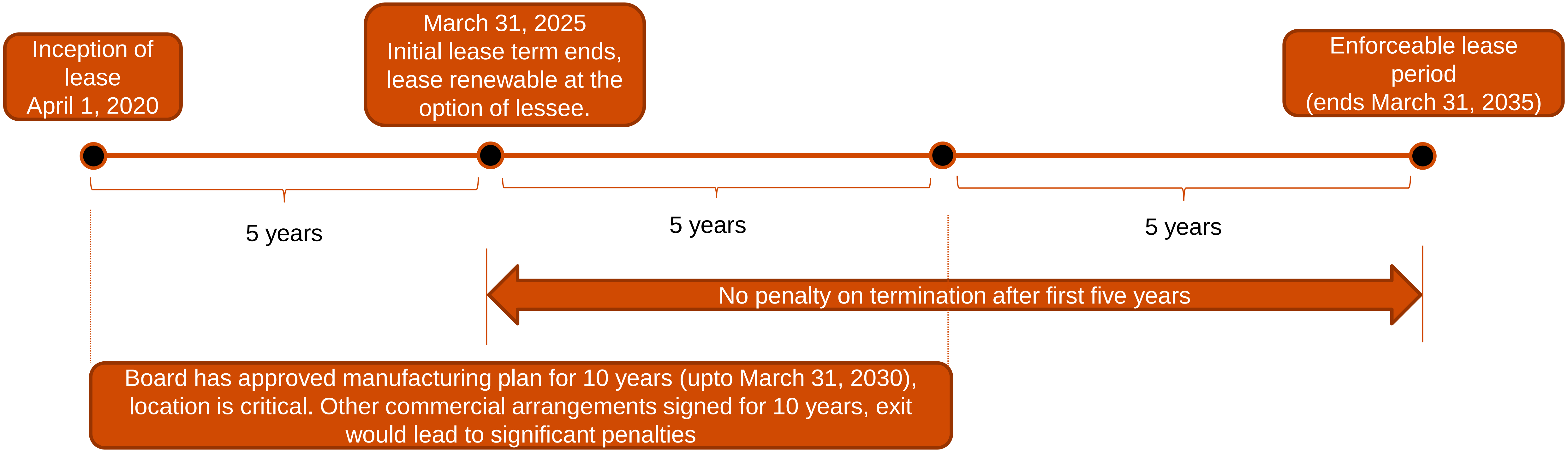
Answer: Entity X has the right to control and use the aircraft.

Analysis:

Entity X's rights	Entity Y's rights
• Makes all relevant decisions regarding whether, where and when the aircraft travels, as well as the passengers and cargo that it will transport through the period of use *(Entity X has the right to obtain substantially all of the economic benefits from use of the aircraft throughout the period of use.)* • Has the right to change these decisions throughout the period of use.	• Contractual restrictions about where the aircraft can fly define the scope of Entity X's right to use the aircraft. They are protective rights that protect Entity Y's interests, e.g. its investment in the aircraft or to ensure that Entity Y is in compliance of applicable laws and regulations. • Entity Y operates the aircraft but Entity Y's decisions in this regard do not give it the right to direct how and for what purpose the aircraft is used. Instead, these decisions are dependent upon Entity X's decisions about how and for what purpose the aircraft is used.

Ind AS 116 Leases

What should the entity consider as the lease term?



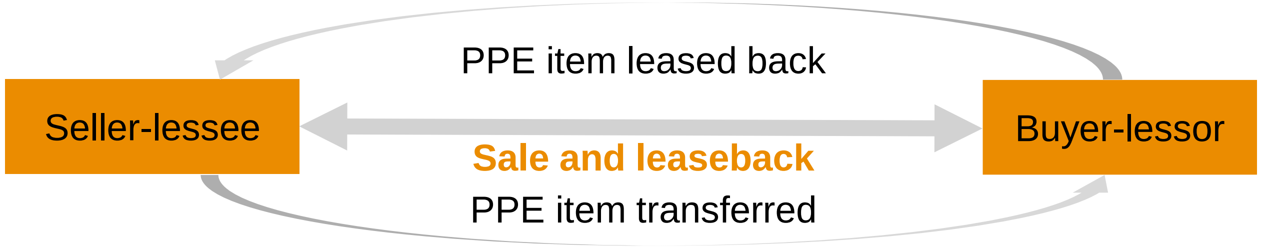
Answer: Ten years

Sale and Leaseback with Variable Payments

An entity (seller-lessee) enters into a sale and leaseback transaction in respect of an item of property, plant and equipment (PPE). Significant terms of the arrangement are:

- Lease back period is five years.
- Transfer satisfies the requirements in IFRS 15 to be accounted for as a sale of PPE.
- Consideration paid by the buyer-lessor to the seller-lessee for the PPE equals its fair value at the date of the transaction.
- Lease payments (which are at market rates) are variable, calculated as a percentage of the seller-lessee's revenue generated using the PPE.
- Lease payments are not considered as in-substance fixed payments as described in Ind AS 116.

- *Source: Tentative Agenda Decisions*



Ind AS 116.100: "...the seller-lessee shall measure the **right-of-use asset** arising from the leaseback at the proportion of the previous carrying amount of the asset that relates to the right of use retained by the seller-lessee. Accordingly, the seller-lessee shall recognise only the amount of any **gain or loss** that relates to the rights transferred to the buyer-lessor. …"

Ind AS 116 Leases

Sale and Leaseback with Variable Payments

PPE carrying value	**INR 1,000,000**
Transaction price	**INR 1,800,000**
PV of expected payments (all variable) over the lease term	**INR 450,000**
PV of lease payments to FV of PPE (%)	**25%**

ROU asset	INR 250,000 (25% of INR 1,000,000)
Gain/loss on sale	INR 600,000 [75% of (INR 1,800,000 – INR 1,000,000)]
Liability*	Dr Cash INR 1,800,000 Dr ROU asset INR 250,000 Cr PPE INR 1,000,000 **Cr Liability* INR 450,000** Cr Gain INR 600,000

*The IASB has added a project to its agenda to consider the subsequent measurement of this liability.

Ind AS 101 First-time Adoption of Indian Accounting Standards

Facts:
Entity X will be presenting its first Ind AS financial statements for the year ending 31 March 2021. The date of transition to Ind AS will be 1 April 2019, and the opening Ind AS balance sheet is prepared as at this date.

Entity X acquired one business every year from March 31, 2015 to 2020, and it accounted for the business combinations in accordance with previous Indian GAAP. Entity X intends to apply the business combinations exemption under Ind AS 101, and so it will not restate any business combinations in the years from March 31, 2015 to 2017. However, entity X wants to restate the accounting entries that it made in connection with the March 31, 2018 business combination, but it does not want to restate the acquisitions made in March 31, 2019 and 2020.

Question: Is this in accordance with Ind AS 101?

Answer

Entity X can elect not to restate any business combinations before the date of transition to Ind AS. However, if it elects to restate any business combinations, then all subsequent business combinations must also be restated. Entity X must also restate the combinations in March 31, 2019 if it elects to restate the acquisition in March 31, 2018.
Entity X cannot avoid restating the business combination transaction in March 31, 2020. This transaction took place in the period covered by the comparatives in the first Ind AS financial statements. Entity X must, therefore, apply Ind AS 103 to this business combination, because the business combination standard is in force at the end of the first Ind AS reporting period (i.e 31 March 2021).

How should one off tax disallowances be considered in calculating tax in each interim period?

Full year scenario:

Particulars	H1	H2	Total
Profit/ (loss) before tax	(500,000)	550,000	50,000
Disallowance under tax	140,000	160,000	300,000
Taxable profit/ (loss)	(360,000)	710,000	350,000
Tax charge @30%			105,000
Profit/ (loss) after tax			(55,000)

Effective tax rate for full year

Considering one off disallowances	Without considering one off disallowances
$\frac{105,000}{50000} = 210\%$	$\frac{15,000}{50,000} = 30\%$

Applying effective tax rate on taxable profit may have a distortive effect on the results:

Particulars	H1	H2	Total
Profit/ (loss) before tax	(500,000)	550,000	50,000
Tax charge/ (credit) @210%	(1,050,000)	1,155,000	105,000
Profit/ (loss) after tax	550,000	(605,000)	(55,000)

Instead calculate effective tax rate excluding one off disallowances, and consider tax effect of disallowances in the respective quarters:

Particulars	H1	H2	Total
Profit/ (loss) before tax	(500,000)	550,000	50,000
Tax charge/ (credit) on profits @ 30%	(150,000)	165,000	
Tax on disallowance @30%	42,000	48,000	
Total tax	(108,000)	213,000	105,000
Profit/ (loss) after tax	(392,000)	337,000	(55,000)

Ind AS 34 Interim Financial Reporting

A paint manufacturer is preparing results for the six months ended September 30, 2021. The manufacturer offers rebates on sales (for financial year cycle) based on the following volumes:

Upto 100,000 litres	No rebate
100,000litres – 250,000 litres	5% rebate on all sales
Over 250,000 litres	10% rebate on all sales

A particular customer has purchased 140,000 litres of paint. The customer has past history of purchasing over 250,000 litres of paint every year.

Should the manufacturer estimate a rebate of 5% or 10% in the results as at September 30, 2021?

Answer: 10%

Analysis: The manufacturer concludes that the transaction price should incorporate a rebate of 10%, because this is the amount for which it is highly probable that a significant reversal of cumulative revenue will not occur if estimates of the rebates change.

Ind AS 21 The Effects of Changes in Foreign Exchange Rates

Pays non-refundable advance of USD 1 million on July 1, 2020
(1 USD = INR 74)

Entity A
(Buyer)

Entity B
(Supplier)

Supplies goods on April 1, 2021 for USD 1 million
(1 USD = INR 70)

Question: Should Entity A translate ‘Advance given to supplier’ as at March 31, 2021?

Answer: An advance which is not expected to be settled in cash is considered a non-monetary item and hence should not be translated as at the year end.

Ind AS 21 The Effects of Changes in Foreign Exchange Rates

Accounting for exchange differences on inter-company loans in consolidated financial statements

Holding company
India

Subsidiary A
India
Functional currency is INR

Loan of USD 1 million given on April 1, 2020
1 USD = INR 74

On March 31, 2021, 1 USD = INR 70

Subsidiary B
USA
Functional currency is USD

Standalone financials of Subsidiary A	**Standalone financials of Subsidiary B**	**Consolidated financial statements** functional currency is INR
Foreign exchange loss: 1 million X (74-70) = INR 4 million	No foreign exchange gain/ loss as both: • functional currency of the entity and • currency of loan are in USD.	Credit Loan given by subsidiary A: INR 70 million Debit Loan taken by subsidiary B: INR 70 million However, the exchange loss of Subsidiary A reported in Subsidiary A's separate financials- would be consolidated, and that loss remains in the consolidated P&L

A foreign currency loan even when within the group gives rise to an exposure to foreign currency risk in the Consolidated P&L!

Ind AS 23 Borrowing Costs

Facts:

Entity A acquires and develops land and thereafter constructs a building on that land. Both the land and the building meet the definition of a qualifying asset, and entity A uses general borrowings to fund the expenditures on the land and construction of the building.

Question: Should entity A cease capitalising borrowing costs incurred in respect of expenditures on the land once it starts constructing the building, or should it continue to capitalise borrowing costs incurred in respect of land expenditures while it constructs the building?

Answer:

Entity A should consider the intended use of the land – for example, whether land and building are intended to be used for owner-occupation, rent/capital appreciation or sale. Entity A considers if the land is capable of being used for its intended purpose while construction on the building is still continuing. If the land is not capable of being used for its intended purpose, entity A considers the land and building together to assess when to cease capitalising borrowing costs on the land expenditures.

Ind AS 23 Borrowing Costs

- An entity includes funds borrowed specifically to obtain an asset other than a qualifying asset as part of general borrowings.
- If a specific borrowing remains outstanding after the related qualifying asset is ready for its intended use or sale, it becomes part of the fund an entity borrows generally.
- Accordingly, an entity to use all outstanding borrowings in determining the capitalisation rate, except those made specifically to obtain a qualifying asset not yet ready for its intended use or sale.
- Previously, there was a diversity in practice due to lack of clarity in the wording in Ind AS 23.

Ind AS 37 Provisions, Contingent Liabilities and Contingent Assets

Facts:

- Entity is planning restructuring of a factory, year end is March 31, 2021
- The entity has made an announcement on January 1, 2021 about the restructuring, including the functions and the number of employees likely to be affected.
- There is a 90 day consultation period, so individual employees were not notified by year end.

Question: Can the entity provide for restructuring costs as at March 31, 2021?

Answer:

- It is not necessary for individual employees to have been notified as at year end
- The notification of employee representatives could create a constructive obligation
- It will be necessary to consider what is involved in the specific consultation- for example, the announcement will create a constructive obligation *if the negotiation is about terms* rather than something that could change the entity’s plans (which have already been announced in detail).

Ind AS 37 Provisions, Contingent Liabilities and Contingent Assets

Facts:

- Entity A’s plant has been destroyed in a fire on January 31, 2021. Entity A has a fire insurance policy which covers damages consequent to fire.
- Entity A has filed a claim with the insurer. As at March 31, 2021, the survey is still in progress.
- Management of entity A is of the opinion that insurance receivable should be recognised as an asset as there is valid insurance policy and the claim is covered in scope of the insurance policy.
- Management of entity A has obtained a legal opinion stating that it is virtually certain that insurance claim is recoverable.

Question: Should entity A recognise asset towards the insurance claim as at March 31, 2021?

Answer: No, the remaining uncertainty is not insignificant, as the insurance survey is in progress, and the claim has not yet been accepted/ confirmed by the insurer.

Graded vesting:

Entity A grants 2,400 share options to employees on April 1, 2020. 25% of the options vest each year, and all employees may exercise options after five years. How should the expense towards share based payment be accounted? Assume fair value of INR 1 per option.

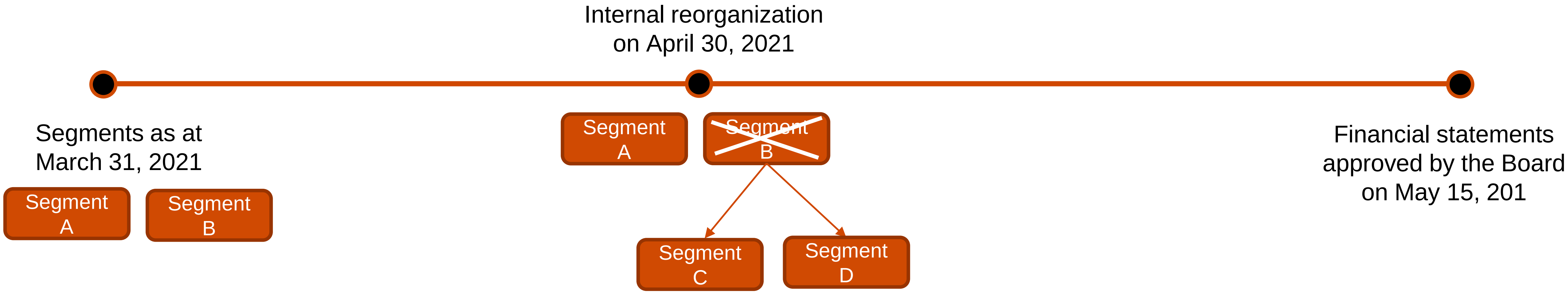
Year ended	Tranche A (25%) 600 options (vests on Mar 31, 2021) This tranche vests over 1 year	Tranche B (25%) 600 options (vests on Mar 31, 2022) This tranche vests over 2 years	Tranche C (25%) 600 options (vests on Mar 31, 2023) This tranche vests over 3 years	Tranche D (25%) 600 options (vests on Mar 31, 2024) This tranche vests over 4 years	Total by year
March 31, 2021	600	(600/2)=300	(600/3)=200	(600/4)=150	1,250
March 31, 2022	-	(600/2)=300	(600/3)=200	(600/4)=150	650
March 31, 2023	-	-	(600/3)=200	(600/4)=150	350
March 31, 2024	-	-	-	(600/4)=150	150
Total by tranche	**600**	**600**	**600**	**600**	**2,400**

Ind AS 102 Share based Payment

Intra-group share based payments

If holding company cross charges the expense	If holding company *does not* cross charge the expense
In the books of holding company: Debit Receivable from subsidiary Credit Share option reserve *(based on vesting of options)* Debit Share option reserve Credit Equity share capital *(on exercising of options)*	**In the books of holding company:** Debit investment in subsidiary--→ nature is deemed investment Credit Share option reserve *(based on vesting of options)* Debit Share option reserve Credit Equity share capital *(on exercising of options)*
In the books of subsidiary: Debit Employee share based expense Credit Share option reserve *(based on vesting of options)* Debit share option reserve Credit Payable to holding company *(when debit note is received)*	**In the books of subsidiary:** Debit Employee share based expense Credit Share option reserve--→ nature is deemed capital *(based on vesting of options)*

Ind AS 108 Operating Segments



Question: Should the new segment structure be presented in the financial statements?

Answer: New segment structure should not be presented until operating results, managed on the basis of new segment structure, are reported to the CODM.

Ind AS 108 Operating Segments

Question: An entity has a single reportable segment. Is the entity required to give disclosures under Ind AS 108?

Answer: Minimum disclosures are required under Ind AS 108 even if an entity has a single reportable segment.

The disclosures required are:

- Revenues from external customers for each product and service, or each group of similar products and services.
- Geographical information- Revenue attributed to country of domicile and revenue attributed to foreign countries (disclose separately any material revenue attributed to a single foreign country.
- Non-current assets (other than specified exceptions) by geography on the same principles as above
- Extent of reliance on major customers
- Revenue exceeding 10% from a single customer.

Reverse factoring arrangements

A Company (or “buyer”) has entered into an agreement with an Exchange. The Exchange is an intermediary which brings together the buyer, financier (which is a banking institution) and the supplier on a portal for factoring of trade invoices.

Key terms of the arrangement:

- On the due date of the invoice, the supplier approaches the buyer for settlement on the portal. The buyer accepts the request for reverse factoring on the portal and confirms the genuineness and correctness of the invoices.
- The buyer selects the financier and negotiates the terms of the financing (including the credit period and interest rate). The credit period availed by the Company from the financier is around 90 days. The normal credit period offered by suppliers is ~ 45 days.
- The supplier enters into a deed of assignment and legally transfers the right to receive collections on the invoices to the financier. The assignment is without recourse to the supplier. The notice of assignment confers the right on the financier to receive payment from the buyer.
- The Company bears the interest and other incidental costs related to reverse factoring.

Ind AS 1 Presentation of Financial Statements

Question: How should the Company present the amount due to be payable to the financier in the balance sheet?

Trade payables	Borrowings	Other current liabilities

Response:

Borrowings

Ind AS 1 Presentation of Financial Statements

Facts:

- Entity A had recognized a liability for Professional expenses during the year ended March 31, 2018.
- During the year ending March 31, 2021, the entity has reversed the liability, as that liability is no longer payable.

Question:

How should the entity present the gain on reversal of the liability, in the Statement of Profit and Loss?

Answer:

The gain arising on reversal of liability should be presented in the same line item in which the original expense was recognized (and not Other income).

Ind AS 1 Presentation of Financial Statements

Presentation of exceptional items in statement of profit or loss

Facts:

Entity A is under the administrative control of the Government of India. The entity is eligible for feedstock subsidy, subject to approval of the Government of India. The entity commenced operations in FY 2015-2016.

- The Government of India accorded approval of feedstock subsidy on 24 December 2019 to Entity A for 15 years from the commencement of operations to maintain minimum internal rate of return (IRR) of 10% (post-tax).
- During the year ended 31 March 2020, Entity A recognised the previous year’s accumulated feedstock subsidy amounting to Rs. 1,300 crores approx as an income.
- The previous years’ accumulated feedstock subsidy represented 50% of Entity A’s revenue from operations for the year ended 31 March 2020.

Query:

Can entity A present feedstock subsidy claims for previous years as an ‘exceptional item’ in the statement of profit and loss for the financial year ended 31 March 2020?

View:

Exceptional items are those items which meet the test of ‘materiality’ (size and nature) and the test of ‘incidence’; and that all material items are not exceptional items.

Just because the recognised subsidy is an accumulated amount pertaining to past years, it cannot be considered as having one time incidence or non-recurring. Further, the feedstock subsidy will be received by the Company for a period of 15 years from the date of commissioning and hence will arise even after the financial year 2019-20 (although may be pertaining to the current reporting period only).

Since the test of “incidence” will fail, the subsidy amounts of prior years cannot be classified as ‘exceptional item’.

Source: EAC Opinion

Ind AS 1 Presentation of Financial Statements

Presentation of gain or loss on account of mark-to-market valuation of the derivative contracts resulting from movements in exchange rates and interest rates of the underlying currencies

Facts:

A company operates overseas projects directly and/or through subsidiaries, by participation in various joint arrangements and investment in associates.

- In order to finance its overseas operations, the company arranges external commercial borrowings including but not limited to debentures and bonds denominated in external currencies
- The said borrowings denominated in external currencies involve, inter alia, exchange risk. In order to hedge the exchange risk, the company enters into various derivative contracts. The company measures these derivatives at fair value through profit or loss (FVTPL) in accordance Ind AS 109 i.e. hedge accounting is not applied.

Query:

How should the Company present the gain or loss on fair valuation of derivative contracts taken to hedge currency fluctuations on borrowings?

View:

- It would be appropriate to present the net gain or net losses on fair valuation of the derivative contracts as 'Other borrowing cost' under the head 'Finance costs'.
- Separate disclosure of the net gain or loss on the said derivative contracts and the interest expense on the foreign currency external commercial borrowings should be made within the 'Finance costs' note in the financial statements.
- Disclose the presentation policy of the mark-to-market gain or loss on the derivative contracts.

Source: EAC Opinion

Ind AS 24 Related Party Disclosures

Question: Do an entity's key management personnel include non-executive directors?

Answer: Yes; 'key management personnel' includes "any director (whether executive or otherwise)". The term 'or otherwise' is intended to cover non-executive directors and supervisory board members, as well as those who have responsibility for the management and direction of a significant part of the business without holding the title 'director'.

ICAI FRRB comments on compliance with Ind AS

Ind AS 101- Reconciliation between previous GAAP and IND AS not provided for items in the balance sheet.

Ind AS 23- Borrowing costs capitalized upto the ‘date of put to use’ rather than the ‘date when the asset is ready for its intended use or sale’.

Ind AS 37- Expense for VRS recognized as incurred (rather- they should be recognized as liability and expense when the entity can no longer withdraw those benefits and when the entity recognizes costs for restructuring that includes termination benefits).

Ind AS 1- Loan from related party which is interest free and repayable on demand, was classified as a non-current liability.

Ind AS 24- Corporate guarantees issued by holding company w.r.t loan taken by subsidiary. However, no disclosures were made in the subsidiary’s financials on the corporate guarantee.