Ind AS 115, *Revenue from Contracts with Customers* introduces a single comprehensive model of accounting for revenue arising from contracts with customers and will supersede the current revenue recognition guidance. In this edition of Accounting and Auditing Update (AAU), we focus on the telecommunication sector which has a varied range of products and services that could be bundled in many different ways. Therefore, telecommunication sector companies would need to evaluate the impact of Ind AS 115 on revenue recognition, transition and disclosures. Our article on this topic highlights the significant areas where current guidance in Ind AS is expected to change due to implementation of Ind AS 115. This standard is expected to be applicable to Indian companies covered in the Ind AS road map from 1 April 2018.

The consolidated financial statements of fund managers which are classified as Banks and Non-Banking Financial Companies would need to be prepared in accordance with Ind AS 110, *Consolidated Financial Statements* from 1 April 2018. Accordingly, they would need to consolidate funds after evaluating the factors relating to ‘delegated power’. Our article on this topic explains major considerations to determine whether fund managers should consolidate the funds managed by them under Ind AS.

Integrated Reporting expects to bring together the diverse but currently disconnected strands of reporting into a coherent, integrated whole, and demonstrate an organisation’s ability to create value now and in the future. Additionally, many organisations report on the United Nation’s sustainable development goals. Our article highlights a new approach to Integrated Reporting and UN’s sustainable development goals. This approach has been developed by the Integrated Reporting Council (IIRC) and the Institute of Chartered Accountants of Scotland (ICAS).

Under Ind AS, the accounting of joint operations is driven by a principle rather than form of the arrangement. Our article on joint operations highlights the factors to be assessed for determining whether an arrangement is a joint operation, the accounting in separate and consolidated financial statements and certain practical implications.

As is the case each month, we also cover a regular round-up of some recent regulatory updates in India and internationally.

We would be delighted to receive feedback/suggestions from you on the topics we should cover in the forthcoming editions of AAU.
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IFRS 15, *Revenue from Contracts with Customers* is applicable for accounting periods beginning on or after 1 January 2018. Ind AS 115 being the equivalent standard to IFRS 15, is expected to become effective for accounting periods beginning on or after 1 April 2018. This necessitates companies to look at their revenue recognition policies and practices and do a complete evaluation of the impact of the new standard since accounting as per Ind AS 115 is expected to bring about significant changes in the way companies recognise, present and disclose their revenue.

Ind AS 115 provides guidance on modification of contracts, capitalisation of contract costs, repurchase agreements, etc. for which adequate guidance was not available under current accounting standards. Ind AS 115 also provides certain transition options and practical expedients to transition from the existing revenue recognition standard to Ind AS 115. Each transition option and practical expedient would have different financial implications, reporting and system requirements. Therefore, careful evaluation of each option and practical expedient is required.

Accounting under Ind AS 115 and changes from existing practice would be critical for telecommunication companies considering the dynamics in which these companies operate with varied products and services and different possible combinations thereof. Hence, many telecommunication companies around the world started preparing for the standard well in advance for implementation of this standard. Certain Ind AS 115 implementation issues that require careful consideration by telecommunication companies have been discussed in this article.
Key considerations for telecommunication companies

1. Bundled arrangements

Telecommunication companies often come out with arrangements where two or more products are sold together for a bundled price. For example, telecommunication plan with a commitment period would be provided to a customer along with any or combination of following: handset, pocket router, set-top boxes, premium number, free value added services, shopping vouchers, fixed line internet, extended warranty, etc.

Ind AS 115 requires an entity to identify the Performance Obligations (PO) in a contract whereas current accounting standards contain limited guidance on identifying whether a transaction contains separately identifiable components. At contract inception, an entity evaluates the promised goods or services to determine which goods or services (or bundle of goods or services) are distinct and therefore, constitute performance obligations.

A good or service is distinct if both of the following criteria are met (given in the diagram below).

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**Criterion 1:**

**Capable of being distinct**

Can the customer benefit from the good or service on its own or together with other readily available resources?

**Criterion 2:**

**Distinct within context of the contract**

Is the entity’s promise to transfer the good or service separately identifiable from other promises in the contract?

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Example

A telecommunication company T enters into a contract with customer R that includes the delivery of a handset and 24 months of voice and data services for a monthly consideration of INR5,000. The contract does not require any payment of consideration upfront as long as the customer commits to a 24 months contract. Customer R obtains title to the handset. The handset can be used by customer R to perform certain functions – e.g. calendar, contacts list, email, internet access, accessing applications via Wi-Fi, and to play music or games.

Company T concludes that the handset and the wireless services are two separate performance obligations based on the evaluation that the customer can benefit from the handset on its own and both handset and wireless services are also separate in the context of the contract as a whole.

Currently there are wide practices of revenue recognition for bundled arrangements. Few telecommunication companies do not recognise handset revenue when handsets are given free along with the wireless plan, whereas few companies allocate revenue to both components using the residual approach. Ind AS 115 provides accounting at the performance obligation level based on their respective stand-alone selling prices and therefore, there would be an impact on financial statements based on the current practice followed for revenue recognition for such arrangements.

Although the analysis can be straightforward in certain cases, in other cases, the analysis of whether equipment can be assessed as a separate PO may not be straightforward. This is due to the fact that telecommunication entities may not regularly sell equipment, such as phones, wireless devices, modems and set-top boxes without its own network service. Also, much of the equipment may be proprietary and locked to the telecommunication company’s network. In such cases, analysis may require careful consideration of factors such as existence of secondary markets and alternative dealers, other add-on functionalities of the equipment such as storage facilities in set-top boxes, etc. and require application of significant judgement.
2. Identification of performance obligations within telecommunication services

A telecommunication entity typically offers arrangements that can include varying service combinations, such as wireless, internet, television and landline voice. Further, telecommunication offer various sign-on offers such as free talktime, free data, etc. to induce new customers to subscribe or migrate to their network. After determining whether telecommunication equipment is distinct in context of the telecommunication contract, telecommunication companies may have to determine if the various services are distinct from one another, although they may be provided concurrently.

For example:

Telecommunication company A contracts with customer C to provide cable television, internet and landline voice services for a fixed monthly fee for 24 months. Customer C can benefit from each of the three services on their own (i.e. customer C can benefit from cable television without either of the other contracted services). None of the three contracted services are highly interrelated or interdependent because customer C is able to purchase any of the three services separately. Furthermore, company A does not provide a significant integration service in the contract as these services are not inputs to a combined service offering that significantly modifies or customises any of the other stand-alone service offerings.

The company A concludes that each of the three services is a distinct good or service. However, as a practical matter, because the three services are provided concurrently, company A may conclude that it is acceptable to account for the bundle as a single performance obligation, if they have the same pattern of transfer. The classification of the revenues received should be considered, however, for disaggregated revenue disclosure or segment reporting requirements, as well as management, regulatory or tax reporting.

Another consideration in this matter is determining a measure of progress required at Step 5 – Revenue recognition. For example, certain telecommunication companies allow rollover of unutilised allowances to the next month and allow accumulation until a certain limit. Currently many telecommunication companies recognise wireless services revenue on pro-rata monthly basis i.e. ignoring rollover feature. Under Ind AS 115, telecommunication companies will have to carefully evaluate the substance of roll over feature and if it is substantive, telecommunication companies may not be able to recognise revenue on pro-rata basis. Instead telecommunication companies would have recognised revenue as and when the performance obligations are satisfied i.e. on utilisation of rolled over allowances.

Hence, in such cases, telecommunication entities may end up having different measures of progress for various POs.

3. Variable consideration

Telecommunication companies provide various credits and incentives to the subscribers such as goodwill credits, cashbacks for the renewal, waivers of charges, etc. to maintain their customer base. Many telecommunication companies may opt to currently recognise the credits as and when these are provided to the subscribers in absence of clear guidance under the current accounting standards.

Ind AS 115 recognises these credits as variable consideration and also explains that variability may be either explicit or implicit, arising from customary business practices, published policies or specific statements, or any other facts and circumstances that would create a valid expectation by the customer. As per Ind AS 115, variable amounts are estimated and included in the transaction price using either the expected value method or the most likely amount method. An entity may use a group of similar transactions as a source of evidence when estimating variable consideration, particularly under the expected value method. The selected method should be applied consistently throughout the contract and update the estimated transaction price at the end of each reporting period.

This requirement may pose significant challenges for many telecommunication companies due to the sheer volume of contracts and the variety of possibilities across all contracts.

Example

A telecommunication company A agrees to sell to business C, its customer, voice minutes over a period of one year. Business C promises to pay INR0.15 per minute for the first 100,000 minutes. If minutes purchased exceed 100,000 minutes, then the price falls to INR0.12 per minute for all minutes purchased (i.e. the price is reduced retrospectively). If the minutes purchased exceed 150,000, then the price falls to INR0.10 per minute for all minutes purchased (i.e. the price is reduced retrospectively). Based on company A's experience with similar arrangements, it estimates the following outcomes.

<table>
<thead>
<tr>
<th>Minutes used</th>
<th>Probability</th>
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<tbody>
<tr>
<td>Less than 100,000</td>
<td>70%</td>
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<tr>
<td>100,000 to 150,000</td>
<td>20%</td>
</tr>
<tr>
<td>Over 150,000</td>
<td>10%</td>
</tr>
</tbody>
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Company A determines that the expected value method provides the better prediction of the amount of consideration to which it expects to be entitled. As a result, it estimates the transaction price to be INR0.14 per minute (i.e. \((0.15 \times 70\%) + (0.12 \times 20\%) + (0.10 \times 10\%)\)).

4. Significant financing component

It is quite common for telecommunication companies to provide interest free instalment plan for a handset when a customer enters into a contract for telecommunication service. Customers normally receive a price discount in relation to the services provided by the telecommunication companies in return for agreeing to an instalment plan for purchase of handsets from such telecommunication companies. Such handset plans may be for varied terms such as 12 months, 18 months, 24 months, etc. Also, telecommunication companies sometimes enter into long-term capacity sharing arrangements where consideration in many cases is received in advance.

Under Ind AS 115, while determining the transaction price, an entity would need to adjust the promised amount of consideration for the effects of time value of money, if the timing of payments agreed upon by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant financing benefit. Determination of the significance of the financing component is assessed at each individual contract level. An entity should apply judgement when evaluating whether a financing component is significant to the contract. A practical expedient with Ind AS 115 allows entities not to adjust the transaction price for the effects of a significant financing component if, at contract inception, the entity expects the period between customer payment and the transfer of goods or services to be one year or less.

5. Material rights

The costs involved in acquiring new customers is high and therefore, telecommunication companies, as in many other industries, seek to reduce customer churn by offering incentives and options. For example, a telecommunication company may award points for an amount spent on airtime and a customer could redeem those points for money off their monthly bill or obtain a handset upgrade or it may provide a substantial discount on renewal of contracts.

Ind AS 115 introduces a concept of material right in application guidance and requires entities to evaluate whether options provide material rights to customers and treat them as separate POs.
The following flow chart helps analyse whether a customer option is a performance obligation:

For example:
A customer enters into a one-year service contract with telecommunication company B. The customer agrees to pay INR50 per month. The contract gives the customer the right to renew the contract for an additional year for INR50 per month. Company B estimates that prices charged to customers in the same class will increase to INR56 per month in the next year and that 75 per cent of customers will renew.

In these specific circumstances, based on quantitative and qualitative factors, company B concludes that the renewal option is a material right because the expected discount on renewal is sufficient to influence the customer’s behaviour, and the customer is likely to renew. Therefore, there are two performance obligations in the contract: the first year of service and the material right to renew the contract at a discount.

A telecommunication company B allocates the transaction price of INR600 (12 x 50) to the performance obligations based on their relative stand-alone selling prices. Company B determines that the stand-alone selling price of the current-year service is INR600. Company B estimates the stand-alone selling price of the material right at INR54 by multiplying the estimated monthly discount by the expected likelihood of exercise ((56 less 50) x 12 months x 75%). Company B allocates the transaction price as follows:

<table>
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<tr>
<th></th>
<th>Stand-alone selling prices</th>
<th>Relative percentage</th>
<th>Allocation</th>
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<tbody>
<tr>
<td>Service</td>
<td>600</td>
<td>92%</td>
<td>552</td>
</tr>
<tr>
<td>Material right</td>
<td>54</td>
<td>8%</td>
<td>48</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>654</strong></td>
<td><strong>100%</strong></td>
<td><strong>600</strong></td>
</tr>
</tbody>
</table>

In Year 1, company B recognises revenue of INR46 per month (552 ÷ 12 months). In Year 2, assuming exercise of the option to renew, company B recognises revenue of INR54 per month ((INR48 allocated to the material right + INR50 per month x 12) ÷ 12 months). If the customer does not renew the contract, then company B recognises the 48 allocated to the material right as revenue when the right expires – i.e. at the end of the first year of service, in this example.

Identification of options provided in the contracts and assessing whether it is a material right could be very judgemental especially because telecommunication companies are dynamic with new products being regularly launched and little historical data being available with companies to assess if options would be exercised by customers for the new products.

(Source: Revenue for Telecoms, Issues In-depth, KPMG IFRG Ltd’s publication dated September 2016)
6. Non-refundable upfront fees

Many telecommunication contracts include non-refundable up-front fees that are paid at or near contract inception — e.g. activation fees, set-up fees or other payments made at contract inception. Many telecommunication companies recognise revenue upfront for such non-refundable fees. The new standard provides guidance on determining the timing of recognition for these fees i.e. whether upfront fees is an amount collected for administrative activities which should be recognised over the period of material right or it is an advance received for future goods or services which should be recognised as and when goods and services are provided.

Example

A telecommunication company B charges a one-time activation fee of 25 when customer D enters into a month-to-month contract for a voice and data plan that costs INR50 per month. Customer D has no obligation to renew the contract in the subsequent month. If customer D does renew, then no activation fee will be charged in the second or subsequent months. Company B’s average customer life for month-to-month contracts is two years.

Company B concludes that there are no goods or services transferred to customer D on activation. Therefore, the up-front fee does not relate to a good or service and the only performance obligation in the arrangement is the voice and data plan. The activation is merely an administrative activity that company B must perform to allow customer D to access its network. The activation fee is considered as an advance payment for future goods or services and included in the transaction price in month 1.

Company B then assesses whether the option to renew the contract without paying the activation fee on renewal represents a material right for customer D by considering all factors.

Customer D pays INR75 in month 1 and would pay INR50 in each subsequent month for which renewal occurs. Therefore, the ‘discount’ on the renewal rate is quantitatively material. Company B also notes that customer D is likely to renew the contract beyond the first month, and that his decision to renew is affected significantly by the up-front fee.

Therefore, company B concludes that the activation fee is a prepayment for future goods and services and represents a material right. The activation fee will be recognised over the period for which customer D consumes the services that give rise to the material right.

7. Contract costs

Ind AS 115 requires an entity to capitalise incremental costs to obtaining a contract and costs to fulfil a contract that are not in the scope of another Ind AS.

Costs to obtain

Costs to obtain a contract, generally understood as customer acquisition (or origination) costs, are the directly attributable costs incurred in signing up a new customer. Many telecommunication companies are presently expensing the commission immediately while the standard would require companies to capitalise incremental costs of obtaining a contract (internal and external costs) which could be a significant change. Costs that will be incurred regardless of whether the contract is obtained — including costs that are incremental to trying to obtain a contract, are expensed as they are incurred, unless they meet the criteria to be capitalised as fulfilment costs. However, as a practical expedient, an entity is not required to capitalise the incremental costs to obtain a contract if the amortisation period for the asset is one year or less.

For example:

A telecommunication company E enters into a two-year wireless contract with Customer C that includes voice and data services. The contract is signed at one of E’s stores and the sales employee receives a commission of INR30 when the customer signs the contract. E has also incurred costs related to a two-week advertising campaign. On signing the contract, the customer indicates that he came into the store in response to this advertising campaign.

The commission paid to the sales employee is an incremental cost to obtain the contract with the customer because it is payable only on successfully obtaining the contract. Because the contract term is more than 12 months, the practical expedient does not apply. E, therefore, capitalises the sales commission of INR30 as a cost of obtaining the contract.

In contrast, the advertising costs, although they are associated with trying to obtain the contract, are not incremental costs of obtaining the contract. That is, the advertising costs would have been incurred even if no new customer contracts were acquired. Consequently, E expenses the advertising costs as they are incurred.

E is required to determine the appropriate period to amortise capitalised cost of INR30 taking into account expectations about the renewal of contracts. This would require E to maintain detailed customer history which may be onerous considering the huge customer base that telecommunication companies have.
The costs of adding subscribers to an entity’s customer base can be substantial and complicated by the type of costs involved, including incentives to retailers, commissions paid to external dealers or agents, and sales commissions to the telecommunication company’s staff. Identifying the amount eligible to be capitalised could be complicated where terms of commission pay out are complex e.g. commission paid on renewal, commissions earned on contract modifications, commission contingent on future events, commissions subject to clawback, tiered commission structure, etc.

**Costs to fulfil**

Costs to fulfil are capitalised only if certain criteria are met and the costs are not in scope of other guidance.

Some examples with respect to the cost to fulfil a contract could be the set-up, activation and installation costs (including equipments given to customers that may not be separate performance obligation) incurred by telecommunication companies for setting up a new customer. Companies may allocate direct labour, material and even supervision and depreciation costs towards the cost to fulfil a contract. However, costs to fulfil does not include general and administrative costs unless explicitly chargeable under the contract, costs of wasted materials, labour, etc. This may have significant impact on financial statements as capitalising such costs is not an accounting policy choice. Telecommunication entities that capitalised costs previously also need to determine if their accounting policy complies with the new requirements. Practical expedient discussed above for costs to obtain a contract is not available for costs to fulfil.

**8. Other issues**

**Gross vs net presentation**

In many services such as content provision like music, videos, etc. and mobile payments one or more parties are involved with the telecommunication company to provide the service to the customer. Several issues arise in determining which party in the chain should report the transaction on a gross or net basis.

Ind AS 115 provides specific guidance to assess whether an entity is acting as an agent (net revenue presentation) or principal (gross revenue presentation) in a contract. The focus for such an assessment is shifted to a transfer of control approach from the existing risks and rewards approach. If an entity obtains control of another party’s goods or services before transferring control to the customer, then the entity’s promise is to provide the goods or services itself and hence, it is a principal. However, if an entity does not control the good or service before it is transferred to the customer, then the entity is acting as an agent and arranges for that good or service to be provided by another party.

Assessing who controls the delivery of services could be very critical with contracts containing multiple performance obligations. This requires detailed evaluation of terms and conditions agreed by the company with the customer and inter se amongst the company and the third parties involved in providing the services. Presentation of revenue gross or net may impact revenue based licence fees payable to government.

**Repurchase agreements**

Given the rapid change in technology, telecommunication entities commonly offer their customers upgrades or trade-ins on their equipment – e.g. their wireless handsets. Indirect channel sales may also give the telecommunication entity the right or obligation to buy back the equipment from the dealer. These arrangements may fall under the repurchase guidance, if they do not fall under Ind AS 109, *Financial Instruments* and should be analysed with care.

If an entity has an obligation (a forward) or a right (a call option) to repurchase an asset, then a customer does not have control of the asset. In such cases the arrangement may be accounted either a lease or a financing arrangement depending on the comparison between the original selling price and the repurchase price. Similarly, if a customer has a right to require the entity to repurchase the asset (a put option), then arrangement may be accounted either as a lease or a financing arrangement or a sale with a right of return depending on the facts and circumstances i.e. comparison between the original selling price and the repurchase price, economic incentive to exercise the put option, etc.

**IT system impacts and processes**

Telecommunication companies in their day to day operation make use of many IT systems like billing systems, customer databases, Enterprise Resource Planning (ERP), interface systems, etc. to track end to end transactions with customers. Since principles of Ind AS 115 would change the revenue recognition at the transaction level, appropriate changes would have to be carried out in all the systems to capture the additional information required to recognise and disclose revenue as per Ind AS 115. Considering the volume of transactions, number of IT systems and integration between IT systems, making suitable changes to reflect revenue recognition as per Ind AS 115 would be a key challenge.
Next steps

Telecommunication companies would face significant challenges in transitioning to new revenue recognition standards considering the number of impacted areas, volume of transactions, frequent tweaking of plans to tackle the competition and changes in IT systems to process and report revenues in real time. Any changes from the current practice of revenue recognition would have direct impact on the Average Revenue Per User, commonly referred as ARPU which is a key metric of performance of telecommunication entities. Following are potentially the next steps that telecommunication companies may have to consider:

- In-depth analysis of product offerings and current revenue recognition practices in light of Ind AS 115 principles to assess the accounting impact areas. As changes in accounting policies and data availability are identified in the gap analysis, the areas that will require new judgements, estimates, and calculations will need to be identified.

- Analysis of change in disclosure requirements to identify the incremental disclosures.

- Assess transition options, including the relevant practical expedients and apply an option which is most appropriate considering the reporting objectives, system feasibility, availability of time, etc.

- Assess potential tax, systems and processes and internal control aspects of implementation.

- Managements may consider broader impacts such as reviewing the terms and conditions of existing contracts to renegotiate, train, change management, investor relations, impact on management metrics, changes required to forecasting and budgeting processes, etc.
Under the Indian Generally Accepted Accounting Principles (IGAAP), AS 21, *Consolidated Financial Statements* defines the mechanism for identification of entities whose financial statements are to be consolidated by a company. This mechanism is based on the principle of control, where 'control' is defined as ownership of majority voting rights and/or power to control the board of directors or governing body of the entity. Thus, under IGAAP various entities which were under the authority of the consolidating entity, on which it had ‘substantive rights’, were not consolidated by it, since it did not have any voting rights in them.

Ind AS 110, *Consolidated Financial Statements*, introduces a single consolidation model, which emphasises on power and returns of the entity. While Ind AS 110 continues to base consolidation requirements on the principles of control, it has broadened the definition of control. Accordingly, an investor consolidates an entity when it has power over the entity, exposure to variability in returns, and a linkage between the two.

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1. For the purpose of Ind AS 110, substantive rights relating to an investee are the rights that, the holder (investor) has the practical ability to exercise.
With Ind AS being applicable to all Scheduled Commercial Banks, large Non-Banking Financial Companies (NBFCs), and their group companies\(^2\) with effect from 1 April 2018, they are required to take cognisance of the requirements of these standards and how they differ from their current accounting practice (IGAAP). Fund managers which are classified as NBFCs, will be significantly affected by this implementation, specifically with respect to the consolidation of funds which they manage. Fund managers have been delegated with decision-making authority with regard to the procurement and sale of assets, which are critical to the fund’s operations. However, fund managers do not always have a significant holding in these funds. Under IGAAP, the fund managers are not required to consolidate the financial statements of the funds, since they do not ‘control’ the funds, based on ownership/ control over voting rights. However, Ind AS 110 includes an explicit concept of delegated power. Hence, the consolidation of funds by the fund managers needs to be evaluated considering whether the fund managers ‘control’ the fund in accordance with the requirements of Ind AS 110.

In this article, we aim to illustrate the major considerations in determining the consolidation of funds by fund managers.

**Facts of the case**

R Asset Management Company Private Limited (R) is registered as an NBFC, and is the fund manager of a real estate fund, C. C has been set up as a trust, whose trustees are independent of R. The trustees have set a broad investment mandate for the trust, and R has the discretion to make investments in companies and projects, within that mandate without any further approval either from the trustees of C or the investors. C has 50 other investors, who have rights in proportion to their fund units held, this includes rights to remove the fund manager without cause. However, the approval of at least two-thirds of the total investors is required to take any such decision. R holds five per cent of the total units in C. As per its terms of appointment, it will receive one per cent management fee, calculated on the net asset value of the fund and a performance fee paying 12 per cent of additional profits after management fees once the fund is able to get an eight per cent return. This remuneration is commensurate with the current industry terms.

**Accounting issue**

To evaluate control, the fund manager needs to consider the following three aspects:

- Whether it has power over the fund;
- Whether it has exposure, or rights to variable returns from its involvement with the fund; and
- Whether it has the ability to use its power over the fund to affect the amount of returns earned by it through the fund (the link between power and returns).

R needs to evaluate all three aspects, before it can determine whether it should consolidate the financial statements of C.

**Accounting guidance**

While the first two aspects are generally discernible, however, it is the third aspect (i.e. the link between power and returns) that requires evaluation. The linkage test determines whether power is deemed to be used:

- For oneself, in which case the fund manager is a principal and should consolidate the fund; or
- For others, in which case the fund manager is an agent and should not consolidate the fund.

Figure 1 illustrates the process for evaluating the linkage between power and returns.
### Analysis

**Whether fund manager has power over the fund**

To have power, it is necessary for the fund manager to have existing rights that give it the current ability to direct the activities that significantly affect the returns of the fund. Whether this power is exercised, is irrelevant, when assessing consolidation requirements. In the current case, R has been given the discretion to invest the funds of C in various real estate projects, within the investment mandate set by the trustees. No approval is required either from the trustees or the investors. Since management of the funds of C is critical to its returns and operations, it can be concluded that R has power to direct the relevant activities of C, and hence has power over the fund.

**Whether the fund manager has exposure, or rights to variable returns from its involvement with the fund**

To assess the variability of returns, fund managers need to assess whether the returns are fixed or have the potential to vary as a result of the performance of the fund. Returns can be only positive, only negative or wholly positive and negative, and can take the form of dividends, interest on debt instruments, changes in value of investments, tax benefits, remuneration, etc.

In the current case, R will receive a management fee and a performance fee, which are both based on the returns of the fund. Further, it has a five per cent investment in the fund, whose value will vary with the change in the net asset value of the fund. Hence, the variability in performance of the fund would affect R’s returns. Thus, the fund manager has exposure, or rights to variable returns from its involvement with the fund.

**Link between power and returns**

The assessment of linkage between power and returns by the fund manager, brings out whether it is acting in its own capacity, as an investor (or a principal), or has been delegated the rights by the investor(s), and is acting as an agent for the investor(s). Ind AS 110 provides a number of tests and indicators to assess whether linkage is present, however, from the perspective of the fund manager, the analysis of the below mentioned indicators are of importance.

**Single party, substantive, without cause removal rights**

Where a single party holds substantive removal rights and can remove the fund manager without cause, this, in isolation, is sufficient to conclude that the fund manager is an agent. However, in the current case study, the consent of at least two-thirds of the total number of investors (i.e. at least 34 investors) is required to remove the fund manager. Thus, R would need to consider other factors when determining consolidation of C under Ind AS 110.
Remuneration is ‘at market’

For the fund manager to be an agent, its remuneration needs:

• To be commensurate with the services provided; and
• To include only terms, conditions or amounts customarily present in arrangements for similar services and level of skill, negotiated on an arm’s length basis.

Considering that C has been set up by an independent set of trustees, and 50 unrelated investors have invested in the fund at arm’s length terms, it would be reasonable to assume that the remuneration is in line with industry norms, absent any other evidence to the contrary. R should now assess the other factors that are relevant to its linkage test, which are kick-out rights and aggregate economic interests in the fund.

Kick-out rights

Kick-out rights represent the power held by other parties (generally investors) to remove the fund manager. When assessing kick-out rights, ‘without cause’ rights are required to be considered, which represent that investors need not give any reason, when removing the fund manager. The key attribute of the strength of kick-out rights is the number of investors who need to act together to exercise such a right. The greater the number of parties, the less weighting is placed on their kick-out rights. (At the other end of the scale, single party, without-cause kick-out rights results in manager being classified as agent.) Figure 2 below explains this relative strength.

In the current case study, at least two-thirds of the total investors need to vote towards the removal of the fund manager, considering this, R may conclude that the kick-out rights of the investors in C are widely dispersed, and hence are not very strong.

Aggregate economic interests

Aggregate economic interests of the fund manager are made up of its remuneration (R’s one per cent management fee and 12 per cent performance fee, when returns exceed eight per cent) and other interests (R’s five per cent investment in C’s fund units). Ind AS 110 requires entities to compute the magnitude of and variability associated with its economic interest, on the basis of returns expected. However, it appears that variability associated with the expected level of returns is the primary measure of aggregate economic interest. Hence, R is required to analyse, if Cs performance was a little better or a little worse than expected, what percentage of that variation does R gain or suffer.

The greater the variability of the fund managers interest in a fund, then:

• The greater the weighting placed on its aggregate economic interest; and
• The higher the likelihood that the fund manager is a principal.
Variability of the fund manager’s performance is calculated at an expected level of performance of the fund. Generally, this would be at a level that includes a performance fee, since the performance fees are set with an intention of being achievable. Variability of the fund manager’s performance is calculated relative to the variability of returns of the fund. This can be computed as below:

Assuming the normal return is INR100 million. With a marginal increase in return of INR10 million, the variability at the level of return, which is above the threshold rate (eight per cent) can be calculated as follows:

<table>
<thead>
<tr>
<th>Total</th>
<th>Fund managers share</th>
</tr>
</thead>
<tbody>
<tr>
<td>10.00</td>
<td></td>
</tr>
<tr>
<td>(1.10)</td>
<td>1.10</td>
</tr>
<tr>
<td>(0.11)</td>
<td>0.11</td>
</tr>
<tr>
<td>8.79</td>
<td>at 5% 0.44</td>
</tr>
</tbody>
</table>

Variability as percentage of marginal return of 10 1.65/10 16.48%

In other words, for a marginal change of INR10 million above the threshold rate, R receives INR1.65 million more or less. Variability is therefore 16.48 per cent.

**Combining the two indicators**

Stronger kick-out rights favour a conclusion of agent, and a larger aggregate economic interest favours a conclusion of principal. Considering this relation between the two indicators, R should exercise judgement to determine how to apply the relationship to specific cases and conclude whether R is acting as a principal or an agent. Entities may use a matrix approach wherein for each category of kick-out right strength, the fund manager could identify a level of aggregate economic interest for which it is clearly an agent and another for which it is clearly a principal. A marginal zone would then appear between these points. Such a matrix is presented in Figure 3 below.

**Figure 3: Combined evaluation of the two indicators**

(Source: KPMG in India’s analysis, 2018 read with IFRS Practice issues—Applying the consolidation model to fund managers, KPMG IFRG Ltd.’s publication dated March 2012)
Ind AS are largely converged with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB). In this case, since Ind AS 110 does not provide any further guidance on the extent of relation between kick-out rights and aggregate economic interest that would result in the fund manager being considered as a principal or an agent, we consider the text of IFRS 10, *Consolidated Financial Statements* for further analysis.

Though IFRS 10 does not provide any bright lines, it provides examples which include combinations of kick-out rights and aggregate economic interests. These examples could be used as a guide to develop a matrix, which can be presented below:

**Figure 4: Matrix for determining principal-agent classification**

<table>
<thead>
<tr>
<th>Kick out strength</th>
<th>Variability of aggregate economic interest</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Clear agent</td>
</tr>
<tr>
<td>Very Strong</td>
<td>[ ]% or less</td>
</tr>
<tr>
<td>Strong</td>
<td>[ ]% or less</td>
</tr>
<tr>
<td>Medium</td>
<td>[ ]% or less</td>
</tr>
<tr>
<td>Weak</td>
<td>[ ]% or less</td>
</tr>
<tr>
<td>None</td>
<td>22% or less</td>
</tr>
</tbody>
</table>

(Source: IFRS Practice issues- Applying the consolidation model to fund managers, KPMG IFRG Ltd’s publication dated March 2012)

Cells in the matrix have intentionally been left blank, aside from the suggestion of the no-kick out right cells. However, from the analysis of the above matrix, we may infer that with no kick-out rights, a variability of aggregate economic interest of 22 per cent or less represents that the fund manager is an agent. R needs to ascertain facts pertaining to its case, to determine its classification, where the kick-out rights are not very strong. Considering figures three and four, R may conclude, that it is an ‘agent’, and hence is not required to consolidate the financial statements of C.
Consider this

- If in the above case study, the kick-out rights had been with cause, then R would not give them any weightage, and the principal-agent analysis would be based solely on the variability of aggregate economic interests. This is because Ind AS 110 (in its illustrations) states that with cause kick-out rights are protective only, and hence are not required to be given any weight in the analysis.

- Ind AS 110 requires entities to look only at substantive rights of the investors. This is specific in the case of kick-out rights, where fund managers are also required to consider other barriers to exercising the kick-out right. These include:
  
  - Financial penalties on the investors who exercise kick-out rights
  - Conditions that narrowly limit the timing of exercise of kick-out rights
  - Absence of mechanism allowing exercise of kick-out rights, for example 75 per cent of the total voting rights should agree to the kick-out of the fund manager, and the fund manager holds 30 per cent of the total voting rights, and
  - Inability to obtain the information necessary for exercise.

However, as with kick-out rights generally, it appears that these are not simple yes/no tests. So while some barriers might be so significant as to accord zero weight to the kick-out rights, others may simply weaken the sliding-scale strength of a kick-out right. If there are no barriers, then there is clearly no effect at all on the strength.

- When performing a combined assessment of the two key factors, there may be cases which fall under the marginal zone. In these cases, a reasoned judgement as to whether the fund manager is a principal or an agent would be required. Other features of the two key indicators may be considered at this point—for example the expected magnitude of the fund manager’s return to the fund’s total return, the likelihood of the expected performance level applied not being reached in all periods, and thus performance fee being paid on an irregular basis, the proportion of investors required to vote together to use a kick-out right, and other such factors.
Introduction

The world in which companies operate is changing. There is a growing awareness that the globe can offer limited resources for the continued existence of humankind. Businesses today are facing capital constraints from a broader range of resources than just finance. As a result, companies are dependent on and manage a broader range of capital such as intellectual, manufactured, social, human, and natural capitals.

A company’s performance is no longer judged by merely the financial numbers and a traditional reporting model may not be able to bridge the gaps in demands for information by various stakeholders. A reporting model needs to include several other factors such as sustainability, good corporate governance and being a responsible corporate citizen.

Various laws, regulations, standards, codes, guidance and stock exchange listing requirements require a company to provide various pieces of information. Thus, more information is being provided by the companies and reports are getting longer because reporting has evolved in separate, disconnected strands, strands. Critical-interdependencies between strategy, governance, operations and financial and non-financial performance are not made clear.

In recent times, companies throughout the world are aiming to give a holistic view of the company to its various stakeholders. Social reporting requirements are largely driven by local regulatory bodies and stock exchanges. To provide for growing demand for a broader sustainability reporting, two significant developments have taken place globally as part of corporate responsibility reporting as given below:

I. The Integrated Reporting (IR) framework: The IR framework has been developed by the International Integrated Reporting Council (IIRC). The framework is expected to support the future development of reporting, reflecting the growing complexity in today’s world. This framework expects to bring together the diverse but currently disconnected strands of reporting into a coherent, integrated whole, and demonstrate an organisation’s ability to create value now and in the future. This framework is written primarily in the context of private sector, for-profit entities of any size but it can also be applied, adopted as necessary, by public sector and not-for-profit organisations.

This article aims to:

- Help companies adopting Integrated Reporting (IR) to align their value creation model with achievements of the Sustainable Development Goals.

Aligning Integrated Reporting with the UN’s Sustainable Development Goals
II. Reporting on the UN’s Sustainable Development Goals: In September 2015, the United Nations (UN) adopted the Sustainable Development Goals (SDGs), a set of 17 goals to end poverty, protect the planet, and ensure prosperity for all as part of a new global sustainable development agenda. Each goal has specific targets to be achieved over the next 15 years.

Below is the snapshot of the 17 UN SDG goals:

It is also resolved to create conditions for sustainable, inclusive and sustained economic growth, shared prosperity and decent work for all, taking into account different levels of national development and capacities. Governments worldwide have already agreed to these goals.

**IR and UN’s SDGs aligned**

International business and trade has a significant impact on sustainable development issues such as environment, natural resource consumption, food security, gender inequality, etc. The SDGs are inter-dependent and contributing to them involves trade-offs, just as an organisation’s outcomes involve trade-offs between multiple capitals. With the growing popularity of the IR and SDGs as benchmarks for corporate reporting, in March 2017 the Institute of Chartered Accountants of Scotland (ICAS) and the IIRC collaborated with the Green Economy Coalition to work on a project to produce a report on IR and the SDGs\(^1\). The project is intended to help organisations adopting IR, to identify and demonstrate how their value creation models align with the achievements of the SDGs. The project was spearheaded by Professor Carol A Adams.

The final report ‘The Sustainable Development Goals, integrated thinking and the integrated report’ (the report) is a conceptual document for integrating SDGs into the business model and strategy of the organisation, aligned to the globally recognised IR framework. This report sets out a framework for contributing to the SDGs in alignment with the multi-capitals model. It recognises limitations to the availability of capital on which organisations rely and the potential to substitute between capitals consistent with the broad view of value creation in the IR framework.

This approach to integrating SDGs will assist organisations in understanding the relationships and dependencies between capitals and the inter-dependencies and potential conflicts between the SDGs.

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\(^1\) Adams, CA (2017) ‘The Sustainable Development Goals, Integrated thinking and the integrated report; published by the IIRC and ICAS.'
Overview of the report
Aligning SDGs with the value creation process

An organisation's business model is the vehicle through which it creates value. That value is embodied in the capitals that it uses and affects. Transformation of the capital will often relate to one or more SDGs. In contributing to the SDGs, companies and other organisations are likely to increase or decrease the availability of various capitals.

For example, increased reliance on renewable energy sources and improving diversity in the work force can enhance natural and human capital and may in turn contribute to the achievement of SDGs 5, 7, 10 and 13. The sustainable development issues which gave rise to SDGs may pose limitations on the availability of capitals on which businesses rely.

The diagram below depicts the alignment of the SDGs with the value creation process:

The five step approach

The IR framework provides an opportunity for organisations seeking to respond to the SDGs to get a board level attention for integrating them into strategy and reporting. The report identifies five steps for contributing to the SDGs through IR value creation process. The report recognises that this is a continuous process and organisational responses to each step are expected to be clearer and insightful with each new cycle of corporate reporting. The five steps approach as discussed in the report are as follows:

1. Understand sustainable development issues relevant to an organisation's external environment: The first step towards integration is for an organisation to identify the relevant external environment factors such as human rights, health, poverty, education. The organisation would need to map these against the relevant SDGs to establish a link between the two. Generally, it is the responsibility of the board or persons responsible for governance in an organisation to create an oversight structure to support value creation in light of the external environment.

Organisations should scan the external environment to identify short, medium and long-term risks and opportunities which need to be considered when developing strategy and evolving the business model. This process should include the identification of risks and opportunities associated with sustainable development. For example, inequality and poverty are a risk factor in some countries i.e. they limit the market for products and services.
Organisations should consider how they can contribute to the sustainable development issues that the SDGs address through their own operations. For example, organisations can contribute to SDG 5 on gender equality and SDG 13 on climate action by improving opportunities for women and reducing their carbon emissions respectively. This will have a positive impact on the future availability and quality of human and natural capital.

Integrated reporters should identify how transformations of the capitals impact on, or contribute to, SDG targets. The external environment should be considered in the value creation process such as environmental challenges, such as climate change, the loss of ecosystems and resource shortages can directly be linked to a number of SDGs.

2. Identify material sustainable development issues that influence value creation: Once an organisation has identified sustainable development issues relevant to the organisation’s external environment in step 1, the next step in this approach is to shortlist ‘material’ sustainable development issues which influence value creation. Not all SDGs may be material to an organisation’s value creation process. Organisations generally involve external and internal stakeholders when identifying appropriate sustainability and other disclosures.

Sound governance is critical throughout this process in order to ensure completeness with respect to both positive and negative issues.

As per the IR framework, the materiality determination process involves identifying, evaluating and prioritising matters based on their ability to affect value creation in the short, medium and long-term. Value is created for the organisation and for others through increases, decreases and transformation of the capitals.

Therefore, when planning their approach to the SDGs, organisations seeking to reassess their mission and purpose and/or to reduce corporate risk and increase opportunities arising from sustainable development issues should identify, evaluate and prioritise which sustainable development issues maximise outcomes for the six capitals and hence, their contribution to the SDG targets.

3. Develop a strategy to contribute to the SDGs through the business model: Having identified sustainable development issues relevant to an organisation’s external environment (step 1) and material issues that could affect value creation (step 2), the next step involves an organisation to develop a strategy that addresses how the business model contributes to the SDGs. This would involve aligning with the business model by identifying inputs and outcomes in terms of the capitals, and how outputs (in terms of products and/or services) and key activities of the organisation affect those capitals. Resource allocation plans can then be developed to ensure achievements of the strategic objectives, including outcomes for the SDGs.

4. Develop integrated thinking, connectivity and governance: Step 4 of this approach is to establish connectivity. Connectivity involves (amongst other things) ‘linking the organisation's strategy and business model with changes in its external environment, such as increases or decreases in the pace of technological change, evolving societal expectations, and resource shortages as planetary limits are approached’. This step includes ensuring sound governance with respect to the processes set out in steps 1-3. It also includes embedding material SDG considerations (identified through steps 1 and 2) and resulting strategies and expected outcomes (Step 3) into the root of the organisation through integrated thinking. Governance processes should be able to deal with conflicting stakeholder needs, the interrelationship between capitals relied upon and the interdependency of the SDGs. This involves integrated thinking mechanisms (such as an appropriate culture, communication systems and training) leading to an enhanced understanding of the relationships.

5. Prepare the integrated report: The final step in this approach is the preparation of an IR. This step involves the preparation of an IR which discusses the process the organisation has followed with respect to the SDGs (i.e. how it has implemented steps 1-4 above). It should say how sustainable development issues limit the availability of one or more capitals, how they have been considered in the development of strategy and how they impact value creation. Transformation of the capital under the IR framework is complex with numerous interdependencies across the capitals, so is the process of contributing to the SDGs where organisations need to consider the interdependencies across the SDGs and the trade-offs between them.

The IR should report on how the business model delivers outcomes (positive and negative) for multiple capitals and how this makes a contribution to the SDGs. That is, organisations are encouraged to report on material contributions to the SDGs, identifying which capitals are being increased, decreased or transformed in the process. For example, an organisation might:

- Describe how it has contributed to SDG 17 (Partnerships for the Goals) and how this has increased social and relationship capital;
- Report its gender pay gap and note how that has enhanced human capital and will lead to a medium- and/or long-term increase in financial capital.
Way forward

This report provides guidance to organisations to be able to link their value creation process to the SDGs. There is a clear relationship between the SDGs and the business model under the IR framework. Aligning business approaches to the SDGs with IR can assist organisations in reducing risk, identifying opportunities and delivering long-term, innovative solutions and technologies for addressing sustainable development. Aligning the two approaches can redirect investment flows to maximise value creation and enhance knowledge of the impact of business activities on sustainable development. The SDGs cannot be achieved without collaboration between the governments, private and public sector organisations. Businesses are being called upon to contribute to the SDGs adopted in 2015 and have a sustainable development agenda for the world until 2030. This report will provide value to businesses as they move forward in corporate reporting to be able to incorporate into their proposals and outputs a more coherent form of reporting particularly in relation to the SDGs.

Adoption of IR in India

In India, the Securities and Exchange Board of India (SEBI) issued a circular dated 7 February 2017 that advises top 500 listed companies which are required to prepare Business Responsibility Report (BRR) to adopt IR on a voluntary basis from the financial year 2017-18. The information related to IR may be provided in the following ways:

- As part of annual report with a separate section on IR
- Incorporating in management discussion and analysis, or
- By preparing a separate report (annual report prepared as per IR framework).

In case the company has already provided the relevant information in any other report prepared in accordance with national/international requirement/framework, it may provide appropriate reference to the same in its integrated report so as to avoid duplication of information. Companies may host the integrated report on their website and provide appropriate reference to the same in their annual report.

Internationally, over 1,750 people have joined the IR network and are leading the way in adopting IR with transformational effects not just on the way they report, but on the way they think and act. Despite the modest global growth, there have been significant increases in IR in four countries namely Japan, Brazil, Mexico and Spain.

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2. Source: https://integratedreporting.org/ir-networks/
3. Source: The KPMG in India - Survey of Corporate Social Responsibility Reporting 2017
Increasing competitiveness in business, has necessitated collaboration and synergy amongst various business houses. Accordingly, several entities enter into joint arrangements having different (and sometimes complicated) legal structures and forms. A challenge thus arises on the accounting for such arrangements.

Under the Indian Generally Accepted Accounting Principles (IGAAP), AS 27, Financial Reporting of Interests in Joint Ventures, the accounting requirements are driven only by whether the arrangements are structured through an entity. For example, jointly controlled operations and jointly controlled assets are in the nature of joint arrangements in AS 27 that do not require existence of an entity. Parties to these arrangements are simply required to recognise assets, liabilities, revenues and expenses arising from them. However, when the same arrangements are structured through an entity, AS 27 classifies them as jointly controlled entities and parties have to account for them using the proportionate consolidation method.

Under Ind AS 111, Joint Arrangements the accounting is driven by a principle, namely that parties to the arrangements should recognise their rights and obligations arising from the arrangements. This would generally result either in the recognition of assets and liabilities and corresponding revenues and expenses or in the recognition of an investment.
Classification of joint arrangements

Under Ind AS 111, joint arrangements are classified either as:

- A joint operation whereby the jointly controlling parties, known as joint operators have rights to the assets and obligations for the liabilities relating to the arrangement
- A joint venture whereby the jointly controlling parties, known as the joint venturers, have rights to the net assets of the arrangement.

The rights and the obligations of the parties arising from the arrangements in the normal course of business are key to determining the type of arrangement, and therefore, its subsequent accounting treatment.

Factors for assessing joint operations

The guidance in Ind AS 111 provides certain indicators that entities can use to assess their rights and obligations to an arrangement. Entities should consider the following indicators:

- The structure and legal form of the arrangement
  This requires analysis of whether the joint arrangement is structured through a separate vehicle, which has a legal form that confers separation between the parties and the vehicle. If so, the arrangement may be considered a joint venture.
  Arrangements that are not structured through a separate vehicle, i.e. structured on the basis of a contractual arrangement only are generally considered to be joint operations. However, certain arrangements may be considered as joint operations even when structured through a separate vehicle. For instance, if the legal form of the separate vehicle does not cause the vehicle to be considered as an entity in its own right (i.e. it does not confer legal separation and the assets and liabilities of the separate vehicle are the assets and liabilities of the parties to the arrangement).
  The terms agreed by the parties in the contractual arrangement
  If the contractual terms specify that the parties have rights to the assets and obligations for the liabilities of the arrangement, then the arrangement could be considered a joint operation, irrespective of its separate structure and legal form.
- Assessment of the relevant ‘other facts and circumstances’
  These include consideration of whether the parties designed the arrangement in a manner that gives them the right to substantially all the economic benefits relating to the arrangement. For example, when the activities are designed to provide an output to the controlling parties and the arrangement is limited from selling to third parties. Further, whether the design of such an arrangement also results in its dependence on the parties on the continuous basis for settling its liabilities. This may also occur in the example above where the parties are substantially the only contributors of cash flows to the operations of the arrangement. Such an arrangement could be considered a joint operation despite its structure and legal form.

Accounting in consolidated and separate financial statements of joint operators

The joint operation is considered to be a part of the joint operator’s business, hence the joint operator recognises its assets, liabilities and transactions, including its share of those incurred jointly, in both its consolidated and its separate financial statements (following line-by-line consolidation procedure). These assets, liabilities and transactions are accounted for in accordance with the relevant standards. The joint operator does not additionally account in its consolidated or separate financial statements for its shareholding in the separate vehicle.

There could be certain practical challenges while accounting for joint operations. They are as follows:

- Recognition of revenue by a joint operator: If a joint operation is structured through a separate vehicle and the assessment of other facts and circumstances results in the joint arrangement being classified as a joint operation, then a question may arise on the accounting for revenue related to the output purchased from the joint operation by the jointly controlling parties.

Ind AS 111 requires a joint operator to recognise its share of the revenue from sale of the output by the joint operation. In this regard, the IFRS interpretations committee clarified that revenue would be recognised by a joint operator only when the joint operation sells its output to third parties. For this purpose, third parties do not include other parties who have rights to the assets and obligations for liabilities relating to the joint operation.
• **Assessment of other facts and circumstances:** The IFRS interpretations committee clarified that in order to classify the joint arrangement as a joint operation as a result of assessing other facts and circumstances, it is necessary to demonstrate that: (a) each party to the joint arrangement has rights and obligations relating to economic benefits of the assets of the arrangement; and (b) each party is obliged to provide cash to the arrangement through enforceable obligations, which is used to settle the liabilities of the joint arrangement on a continuous basis.

• **Joint operator purchases output that differs from its share of ownership in the joint operation:** When a joint operator’s share of output purchased differs from its share of ownership interest in the joint operation, then the IFRS interpretation committee noted that it is important to understand the reason for this occurrence. Judgement would therefore, have to be exercised to determine the appropriate accounting.

**Consider this**

- Each joint arrangement is required to be assessed individually to determine its classification either as a joint operation or a joint venture. In some cases, parties may be bound by a framework agreement that sets up contractual terms for undertaking one or more activities and establishes different joint arrangements for specific activities. Even in this case, each arrangement governed by that framework agreement needs to be assessed separately.

- The joint operators account for their interest in the joint operation in their separate financial statements itself. Hence, no further adjustment is required to be made by the joint operator with respect to its interest in the joint operation, while preparing its consolidated financial statements.
Notification of certain provisions of the Companies (Amendment) Act, 2017

Background

On 3 January 2018, the Companies (Amendment) Act, 2017 (Amendment Act, 2017) received the assent of the President of India.

The Amendment Act, 2017 makes significant changes to the 2013 Act which are aimed at ease of doing business, better corporate governance and enforcement of stringent penal provisions for defaulting companies.

The Amendment Act, 2017 would come into force on a date that central government would, by notification in the Official Gazette, appoint. Different dates may be appointed for different provisions of the 2013 Act and any reference in any provision to the commencement of the Companies Act, 2013 (2013 Act) should be construed as a reference to the coming into force of that provision.

New development

The Ministry of Corporate Affairs has issued the following notification for enforcement of certain sections of the Amendment Act, 2017

- Notification dated 23 January 2018 - Section 1 and 4 notified with effect from 26 January 2018
- Notification dated 9 February 2018 - Notified key sections of the Amendment Act, 2017 including the following:
  - Section 32, Declaration of dividend
  - Section 43, Powers and duties of auditors and auditing standards
  - Section 63, Related party transaction

The MCA issued amendment to certain rules under the 2013 Act

The MCA issued the following rules to amend the existing rules under the 2013 Act:

- **The Companies (Incorporation) Amendment Rules, 2018**: These rules amended the existing forms under Companies (Incorporation) Rules, 2014 relating to application of reservation of name, one person company and form for Simplified Pro forma for Incorporating Company Electronically (SPICE). The amended rules are applicable from 26 January 2018.

- **The Companies (Registration Offices and Fees) Amendment Rules, 2018**: These rules amended the existing rules Companies (Registration Offices and Fees) Rules, 2014 to provide revised fee structure for filings to Registrar of Companies (RoC) under Section 403 of the 2013 Act. The amended rules are applicable from 26 January 2018.

- **The Companies (Appointment and Qualification of Directors) Amendment Rules, 2018**: The amended rules provide that every applicant, who intends to be appointed as director of an existing company shall make an application electronically in Form DIR-3, to the central government for allotment of a Director Identification Number (DIN) along with such fees as provided under the Companies (Registration offices and Fees) Rules, 2014. Further it provides that in case the proposed directors do not have an approved DIN, the particulars of maximum three directors should be mentioned in Form No.INC-32 (SPICE) and DIN may be allotted to maximum three proposed directors through Form INC-32 (SPICE).

- **The Companies (Registered Valuers and Valuation) Amendment Rules, 2018 (Specified government companies exempted)**: As per the amended rules, persons who are rendering valuation services under the 2013 Act, on the date of commencement of these rules, may continue to render valuation services without a certificate of registration under the Companies (Registered Valuers and Valuation) Rules 2018, upto 30 September 2018. In case any valuation or any part of it has not been completed before 30 September 2018, the valuer will complete such valuation or such part within three months thereafter. The amended rules are applicable from 12 February 2018.

- **Companies (Authorised to Register) Amendment Rules, 2018**: The amended rules have issued revised Form URC-1 - Application by a company for registration under Section 366 of the 2013 Act which relates to conversion from firm into company and Limited Liability Partnership (LLP) into company. The amended rules are applicable from 19 February 2018.

- **Companies (Management and Administration) Amendment Rules, 2018**: The amended rules have issued revised Form MGT-6 –Return to the registrar in respect of declaration under Section 89 of the 2013 Act received by the company and Form MGT-15 – Form for filing report on annual general meeting. The amended rules are applicable from date of its publication in Official Gazette.

- **Companies (Audit and Auditors) Amendment Rules, 2018**: The amended rules have issued revised Form ADT-1- Notice to the RoC by company for appointment of auditor and Form ADT-2 –Application for removal of auditors from his/their office before expiry of term. The amended rules are applicable from 19 February 2018.


Specified government companies exempted from the provisions of AS 22/Ind AS 12 relating to deferred tax asset/liability

**Background**

Ind AS 12, *Income Taxes*, prescribes the accounting treatment for income taxes. Ind AS 12 requires an entity to consider the temporary differences between the carrying amount of an asset or a liability in the balance sheet and its tax base and accordingly, recognise Deferred Tax Asset (DTA)/Deferred Tax Liability (DTL) in its financial statements.

Under the previous Generally Accepted Accounting Principles (GAAP), AS 22, *Accounting for Taxes on Income*, governs the provisions relating to DTA/DTL.
New development

The MCA through its notification dated 5 February 2018 provides that the provisions of Ind AS 12 or AS 22 relating to DTA/DTL will not be applicable to a government company which meets the given criterion:

• It is a Public Financial Institution (PFI) as defined under Section 2(72)(iv) of the 2013 Act
• It is a Non-Banking Financial Company (NBFC) registered with the Reserve Bank of India (RBI) under Section 45-IA of the RBI Act, 1934 and
• It is engaged in the business of infrastructure finance leasing with not less than 75 per cent of its total revenue being generated from such business with government companies or other entities owned or controlled by the government.

The above mentioned exemption is effective from 1 April 2017 and is available for seven years (i.e. up to 31 March 2024).

(Source: MCA notification No. S.O. 529(E) dated 5 February 2018)

Ind AS Transition Facilitation Group (ITFG) issued clarifications bulletin 14

The ITFG in its meeting considered certain issues received from the members of the Institute of Chartered Accountants of India (ICAI) and issued its clarifications bulletin 14, dated 1 February 2018, to provide clarifications on seven issues in relation to the application of Ind AS.

The ITFG provided clarification on the following issues:

• Capitalisation of processing charges on a loan taken for acquiring/constructing a qualifying asset
• Accounting for restoration cost in case of a leasehold land
• Advance payments received under contract to supply goods and services
• Approval of a scheme of arrangement post balance sheet date
• Accounting for shares held as stock-in-trade
• Accounting for revaluation surplus under Ind AS
• Debt-equity classification of optionally convertible preference shares.

(Source: ITFG’s Clarification Bulletin 14 issued by ICAI and KPMG in India’s IFRS Note dated 20 February 2018)

ICAI issued SA 720 (Revised)

Recently, ICAI has issued SA 720 (Revised), The auditor’s responsibilities relating to other information which deals with the auditor’s responsibilities relating to other information, whether financial or non-financial information (other than financial statements and the auditor’s report thereon), included in an entity’s annual report. This standard on auditing is effective for audits of financial statements for periods beginning on or after 1 April 2018.

The objectives of the auditor, having read the other information, are:

• To consider whether there is a material inconsistency between the other information and the financial statements
• To consider whether there is a material inconsistency between the other information and the auditor’s knowledge obtained in the audit
• To respond appropriately when the auditor identifies that such material inconsistencies appear to exist, or when the auditor otherwise becomes aware that other information appears to be materially misstated.

The revised SA 720 aims to clarify and increase the auditor’s involvement in respect to other information, defined in the standard as financial and non-financial information, other than the audited financial statements, that is included in an entity’s annual reports. It also includes new requirements related to auditor reporting on other information which has been included in ISA 720 (Revised), The Auditor’s Responsibilities Relating to Other Information issued by International Auditing and Assurance Standards Board (IAASB).

Further, the revised standard also provides the examples of amounts or other items that may be included in the other information. Additionally the revised standard includes the illustrations for auditors’ reports relating to other information.

(Source: ICAI notification dated 21 January 2018)

ICAI has issued an Exposure Draft of Ind AS 117, Insurance Contracts

Background

On 18 May 2017, the International Accounting Standards Board (IASB) issued IFRS 17, Insurance Contracts, which is the first international comprehensive standard to provide guidance on accounting for insurance contracts.

IFRS 17 replaces IFRS 4, Insurance Contracts, which was in the nature of an interim standard pending the completion of the project on insurance contracts by IASB.
New development
With an aim to keep Ind AS updated with revisions made in IFRS and in order to maintain convergence, similar amendments are required in the Indian context. Accordingly, on 12 February 2017, ICAI issued an exposure draft on Ind AS 117, Insurance Contracts.

Ind AS 117 is a comprehensive standard which establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts within the scope of the standard. The objective of Ind AS 117 is to ensure that an entity provides relevant information that faithfully represents those contracts. Ind AS 117 once implemented would replace Ind AS 104, Insurance Contracts.

The exposure draft also includes an appendix which sets out the amendments to other Ind AS that are a consequence of issuing Ind AS 117. An entity would apply these amendments when it applies Ind AS 117.

Comments on the ED may be submitted to ICAI by 31 March 2018.

Also refer KPMG IFRG Limited's publication 'First Impressions: IFRS 17, Insurance Contracts'. The First Impressions is intended to help insurers assess the impact of the new standard and prepare for transition. Additionally, it explains the key requirements of IFRS 17 with the use of illustrative examples and features KPMG’s insights.

ICAI issued an implementation guide to SA 701
On 18 February 2018, ICAI has issued an implementation guide to SA 701, Communicating Key Audit Matters in the Independent Auditor’s Report. SA 701 is a new standard which is applicable in the case of audit of listed entities and casts a new reporting requirement on auditors of listed entities to communicate key audit matters in their audit reports. Further, SA 701 is also applicable in case of audit of unlisted entities in situations where law or regulation requires communication of key audit matters in the audit report. SA 701 is effective for audits of financial statements for periods beginning on or after 1 April 2018.

With an aim to provide appropriate guidance for the auditors so that they can discharge their reporting responsibilities under the new standard in an effective manner, ICAI has issued an implementation guide on SA 701.

The implementation guide contains detailed guidance on various issues involved in this new reporting requirement and has been written in a question and answer format containing Frequently Asked Questions (FAQs) on SA 701 and responses to those questions. Additionally, the implementation guide provides the illustrative examples of key audit matters.

IASB has proposed narrow scope amendments to IAS 19 for pension accounting
IAS 19, Employee Benefits specifies the accounting for various types of employee benefits, including:
- Benefits provided for services rendered – e.g. pensions, lump-sum payments on retirement, paid absences and profit-sharing arrangements and
- Benefits provided on termination of employment.

IAS 19 specifies how a company should account for a defined benefit plan. When a defined benefit plan is amended, curtailed or settled during a reporting period, the entity needs to update the assumptions about its obligation and fair value of its plan assets to calculate costs related to these changes.

The IASB issued narrow scope amendments to IAS 19 in case of plan amendment, curtailment or settlement which specifies how companies determine pension expenses when changes to a defined benefit pension plan occur.

The amendments require a company to use the updated assumptions from this remeasurement to determine current service cost and net interest for the remainder of the reporting period after the change to the plan. Currently, IAS 19 did not specify how to determine these expenses for the period after the change to the plan. The amendments are expected to provide useful information to users of financial statements by requiring the use of updated assumptions.

The amendments are expected to be effective on or after 1 January 2019.

IAASB notification dated 7 February 2018)
KPMG in India offices

Ahmedabad
Commerce House V, 9th Floor, 902 & 903, Near Vodafone House, Corporate Road, Prahlad Nagar, Ahmedabad – 380 051.
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru
Maruthi Info-Tech Centre, 11-12/1, Inner Ring Road, Koramangala, Bengaluru – 560 071.
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh
SCO 22-23 (1st Floor), Sector 8C, Madhya Marg, Chandigarh – 160 009.
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai
KRM Tower, Ground Floor, No 1, Harrington Road, Chetpet, Chennai – 600 031
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Gurugram
Building No.10, 8th Floor DLF Cyber City, Phase II, Gurugram, Haryana – 122 002,
Tel: +91 124 307 4000.
Fax: +91 124 254 9101

Hyderabad
Salarpuria Knowledge City, ORWELL, 6th Floor, Unit 3, Phase III, Sy No. 83/1, Plot No 2, Serilingampally Mandal, Raidurg Ranga Reddy District, Hyderabad, Telangana – 500081
Tel: +91 40 6111 6000
Fax: +91 40 6111 6799

Jaipur
Regus Radiant Centres Pvt Ltd., Level 6, Jaipur Centre Mall, B2 By pass Tonk Road Jaipur, Rajasthan, 302018.
Tel: +91 141 - 7103224

Kochi
Syama Business Center 3rd Floor, NH By Pass Road, Vyttila, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata
Unit No. 603 – 604, 6th Floor, Tower – 1, Godrej Waterside, Sector – V, Salt Lake, Kolkata – 700 091.
Tel: +91 33 4403 4000
Fax: +91 33 4403 4199

Mumbai
Lodha Excelus, Apollo Mills, N. M. Joshi Marg, Mahalaxmi, Mumbai – 400 011.
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida
Unit No. 501, 5th Floor, Advanit Navis Business park, Tower-B, Plot# 7, Sector 142, Expressway Noida, Gautam Budh Nagar, Noida – 201305.
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune
9th floor, Business Plaza, Westin Hotel Campus, 363/3-B, Koregaon Park Annex, Mundhwa Road, Ghorpadi, Pune – 411001.
Tel: +91 20 6747 7000
Fax: +91 20 6747 7100

Vadodara
iPlex India Private Limited, 1st floor office space, No. 1004, Vadodara Hyper, Dr. V S Marg, Alkapuri, Vadodara – 390 007.
Tel: +91 0265 235 1085/232 2607/232 2672
KPMG in India's IFRS institute

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

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

IFRS Notes

Ind AS Transition Facilitation Group (ITFG) issues Clarifications Bulletin 14

20 February 2018

With Indian Accounting Standards (Ind AS) being applicable to corporates in a phased manner from 1 April 2016, the Institute of Chartered Accountants of India (ICAI), on 11 January 2016 announced the formation of the Ind AS Transition Facilitation Group (ITFG) in order to provide clarifications on issues arising due to applicability and/or implementation of Ind AS under the Companies (Indian Accounting Standards) Rules, 2015 (Ind AS Rules).

Since then, ITFG issued 13 bulletins to provide guidance on issues relating to the application of Ind AS.

The ITFG in its meeting considered certain issues received from the members of the ICAI and issued its Clarification Bulletin Bulletin 14 on 1 February 2018 to provide clarifications on seven issues in relation to the application of Ind AS.

This issue of IFRS Notes provides an overview of the clarifications issued by ITFG through its Bulletin 14.

First Notes

SEBI relaxes norms governing schemes of arrangements by listed entities

18 January 2018

The listed entities that desire to undertake a scheme of arrangement or are involved in a scheme of arrangement need to follow the regulations laid down by the Securities and Exchange Board of India (SEBI). On 10 March 2017, SEBI issued a circular which laid down a revised regulatory framework for schemes of arrangements by listed entities and relaxation under Rule 19(7) of the Securities Contract (Regulation) Rules, 1957.

On 3 January 2018, SEBI issued a circular to make certain amendments to the circular dated 10 March 2017. The recent circular is applicable from the date of its issue i.e. 3 January 2018. Some of the key relaxations provided in the circular relate to the following topics:

- Submission of documents to stock exchanges
- Relaxations with respect to locked-in promoter’s shares
- Extended time period for listing of specified securities.

In this issue of First Notes, we have provided an overview of the key amendments/relaxations given in the circular.

New publications

KPMG in India is pleased to launch following two thought leadership publications

Ind AS - ITFG interpretations and application issues

The SEBI ICDR and Listing Regulations checklists (revised 2018)

The publications can be accessed at KPMG in India website.

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

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

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