



Voices on Reporting

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Welcome



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Series of knowledge sharing calls



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Covering current and emerging reporting issues



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Scheduled towards the end of each month



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Look out for our Accounting and Auditing Update, IFRS Notes and First Notes publications



Speakers for the call



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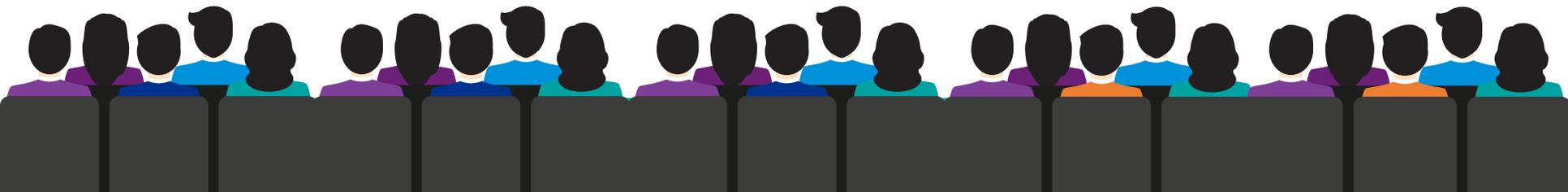
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Agenda

- 1. Ind AS Transition Facilitation Group (ITFG) clarification - Bulletin 16**

2. SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018

3. Certain sections of the Companies (Amendment) Act, 2017 and related rules notified

4. Amendments to Ind AS 20, *Accounting for Government Grants and Disclosure of Government Assistance*

Clarifications on financial guarantee



1. Financial guarantee by a subsidiary for a loan taken by parent

A 100 per cent subsidiary (S Ltd.) has given a financial guarantee to a bank in respect of a loan obtained by its parent (P Ltd.) from the bank. S Ltd. has not charged any guarantee fee/commission to P Ltd. P Ltd. accounts for this loan on an amortised cost basis.

Issue

What would be the accounting treatment of such financial guarantee (meeting the definition of Ind AS 109, *Financial Instruments*) in the separate financial statements of S Ltd. and P Ltd. respectively?

Clarification¹

Accounting by S Ltd. (issuer of the financial guarantee)

- As per Ind AS 109, an issuer is required to recognise a financial guarantee contract initially at its fair value.
- The economic substance of the arrangement is that S Ltd. has made a distribution to P Ltd. as it did not charge P Ltd. the fair value of the guarantee issued.
- *Initial measurement*: Recognise a liability (i.e. deferred income such as 'unearned financial guarantee commission') with corresponding debit to an appropriate head under 'equity'.
- *Subsequent measurement*: Measure liability at the higher of:
 - a) Amount of loss allowance as per Ind AS 109 and
 - b) Amount initially recognised less, when appropriate, the cumulative amount of income recognised in accordance with Ind AS 18, *Revenue*/Ind AS 115, *Revenue from Contracts with Customers* (as applicable).
- At each reporting date:
 - S Ltd. would amortise the unearned financial guarantee commission to income
 - S Ltd. would compare the unamortised amount of financial guarantee commission with the amount of loss allowance determined in respect of the guarantee as at that date.

Clarifications on financial guarantee (cont.)



Accounting by P Ltd. (beneficiary of the financial guarantee)

- Financial guarantee provided by S Ltd. is an integral part of the arrangement for the loan taken by P Ltd. from the bank.
- Fees associated with evaluation and recording of financial guarantee are taken into account to determine Effective Interest Rate (EIR) (as per Ind AS 109) for the financial asset/financial liability.
- Ind AS 109 does not specifically address the accounting for financial guarantees by the beneficiary. An entity needs to exercise judgement in assessing the substance of the transaction and take into consideration relevant facts and circumstances.
- In an arms' length transaction between unrelated parties, the beneficiary of the financial guarantee would recognise the guarantee premium or fee paid as an expense (as an adjustment to the EIR).

In this case, since the issuer (subsidiary) would recognise the liability for the guarantee, the transaction should also be recognised by parent.

- P Ltd. should reflect the distribution by S Ltd. by:
 - Debiting the fair value of the guarantee to the carrying amount of the loan. This would have the effect of such fair value being included in the determination of EIR.
 - Crediting the distribution in accordance with Ind AS 27, *Separate Financial Statements* as below:
 - *If the investment in subsidiary has been accounted for at cost:* Credit the distribution received to the statement of profit and loss. Impairment loss, if any, to be considered separately.
 - *If the investment in subsidiary has been accounted for in accordance with Ind AS 109:*
 - a) If measured at FVOCI: Recognise distribution in the statement of profit and loss unless the distribution clearly represents a recovery of part of the cost of the investment
 - b) If measured at FVTPL: Credit the distribution received to the statement of profit and loss.

Clarifications on financial guarantee (cont.)



2. Financial guarantee given by a parent for a loan taken by its subsidiary and repaid it earlier than the scheduled repayment date



Parent (P Ltd.) provides a guarantee for a loan taken by its subsidiary (S Ltd.) in FY2012 for 10 years. However, S Ltd. repaid the whole loan amount within six years i.e. in FY2018.

On the date of transition to Ind AS (i.e. 1 April 2016), P Ltd. recognised the financial liability in its separate financial statements and presented the resultant impact in 'Investment in subsidiary'.

Issue

What would be the accounting treatment of the financial guarantee provided by P Ltd., when the underlying loan is repaid earlier than estimated initially?

Clarification

- The parent had initially recognised the financial guarantee obligation at its fair value based on the estimated term of the loan as 10 years.
- The early repayment of the loan by S Ltd. in six years is a change in the expected tenure of contractual life of the loan and would be considered as a change in estimate (to be accounted for prospectively) as per Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*.
- As per Ind AS 8, the effect of change in an accounting estimate should be recognised prospectively by including it in profit or loss in the:
 - *Period of the change*: If the change affects that period only, or
 - *Period of the change and future periods*: If the change affects both.
- On repayment of the loan, the parent has no obligation in respect of the financial guarantee issued.
- Therefore, at the end of year six, P Ltd. should reverse the balance outstanding as guarantee obligation. Corresponding credit should be recognised as revenue.

Business combination under common control



- Company A is a subsidiary of company B and both are covered in phase II of the Ind AS implementation.
- During FY2016-17, under the order of the High Court (HC), company B demerges one of its businesses and sold the same to company A against issue of shares.
- Under previous GAAP, company A accounted for the assets and liabilities acquired under the demerger scheme at their respective fair values.

Issue

How should company A account for the business combination in its first Ind AS financial statements for FY2017-18?

Clarification

Scenario A - Accounting treatment of demerger not prescribed in the court-approved scheme

- Acquisition of business by company A from company B is a common control business combination as per Appendix C to Ind AS 103, *Business Combinations*.
- Company A should recognise assets and liabilities acquired at their respective book values as appearing in the books of company B as per pooling of interest method.
- Financial information in the financial statements in respect of prior periods should be restated as if the business combination had occurred from the beginning of the preceding period (i.e. 1 April 2016), irrespective of the actual date of the combination.

Business combination under common control (cont.)



Scenario B - Accounting treatment of demerger prescribed in the court-approved scheme

- As per an announcement by ICAI, accounting treatment of a transaction as required under an order of a court/tribunal (or other similar authority) overrides the accounting treatment that would otherwise be required to be followed in respect of the transaction.
- Company A would follow the treatment prescribed in the scheme in its Ind AS financial statements for the FY2016-17 (comparative to FY2017-18). In case the:
 - Effect of such treatment is to be carried over in subsequent years, the treatment of court approved scheme would be followed
 - Subject to compliance of auditing standards.
- Appropriate disclosures should be provided in the financial statements:
 - Description of the accounting treatment along with the reason that the same has been adopted because of the court/tribunal order
 - Description of the difference between the accounting treatment prescribed in the AS and that followed by the company
 - The financial impact, if any, arising due to such a difference.
- Company A would be required to follow the accounting requirements of Ind AS which are not in conflict with the provisions of the court scheme.

Classification of a lease transaction



A Ltd. entered into a long-term lease arrangement of 99 years for a land in a textile park. As per the terms of the arrangement, A Ltd. would be required to pay an annual lease rent of INR1 per square meter without any upfront payment.

However, A Ltd. has made a lump sum material payment of INR150 crore towards use of common infrastructure facilities of the park during the period of lease (e.g. access roads).

The renewal of the lease is based on the mutual acceptance at the end of lease term. There is no option to purchase the land at a price that is sufficiently lower than the fair value at the date option is exercisable.

Issue

- Whether the lease of land is as an operating lease/finance lease?
- Whether the infrastructure usage rights should be classified under intangible assets or should be considered as part of land lease?

Clarification

- Under the agreement, A Ltd. has the right of use of both land (exclusive basis) and common infrastructure facilities (non-exclusive basis).
- Classification of lease under Ind AS 17, *Leases* requires exercise of judgement in the context of facts and circumstances of each case.
- An entity needs to assess whether the right of use of both land and common infrastructure facilities can be viewed as a single set of rights. If the terms of the agreement such as tenure, renewal option, etc. in respect of the two are different, then they would be accounted as separate rights.
- In this case, upfront payment should be split between Minimum Lease Payment (MLP) towards lease of land and prepayment for future services (for common infrastructure activities).
- The amount allocated to MLPs towards lease of land would be considered for the purpose of determining classification of lease between operating or finance lease.

Classification of a lease transaction (cont.)



- From a presentation perspective:
 - *If the two rights are accounted as a single item:* Relevant line item in the balance sheet may bring out clearly that it relates to right of use of both land and common infrastructure facilities.
 - *If the two rights have been accounted separately:* Accounting for each right should be based on the particular terms and underlying benefits associated with it.

Income tax related to interest and penalties under Ind AS



Issue

- How should an entity account for the interest and penalties related to income taxes, in accordance with the principles of Ind AS?
- Is there any conflict between the treatment as per Ind AS vis-à-vis IFRS?

Clarification

- An entity's obligation for current tax arises because it earns taxable profit during a period and for interest or penalties risen because of its failure to comply with one or more of the requirements of income-tax law.
- Any interest on shortfall in payment of advance income tax is in the nature of finance cost and hence, should not be clubbed with the current tax. An interest should be:
 - Classified as interest expense under 'finance costs'.
 - Such amount should be separately disclosed.
- Penalties which are compensatory in nature should be treated as interest and disclosed under finance costs.
 - Other tax penalties should be classified under 'other expenses'.
- In India, interest and penalty payable under Section 234A/B/C of the Income-tax Act, 1961 (IT Act) would not qualify as income-taxes within the meaning of Ind AS 12. Other interest and penalties under the IT Act are also generally not expected to qualify as income taxes.

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ICDR Regulations, 2018 – Key changes



- On 11 September 2018, SEBI issued the ICDR Regulations, 2018².
- ICDR Regulations, 2018 will come into effect on the sixtieth day from the date of its publication in the official gazette (i.e. 10 November 2018).
- Chapters categorised based on type of offerings so that corresponding information is available at one place.
- Provisions of the 2013 Act, relevant SEBI regulations, circulars, FAQs, etc. have been incorporated.

Following are the key changes:

Financial disclosures in case of public issue

- Consolidated restated financial information would be required for **three years** (earlier for five years).
- **Audited separate financial statements** of the issuer and material subsidiaries would be required to be disclosed on the website of the issuer.
- Exemption from presentation of comparatives for stub period.
- Disclose list of related parties and all related party transactions of the consolidated entities (**whether eliminated on consolidation or not**) as disclosed in their separate financial statements.
- Financial statements of **all foreign consolidated entities should be audited**, unless they are not material* to the CFS and the local regulation does not mandate audit.
- In case issue proceeds would be utilised for a proposed acquisition of material business/entity, provide audited statements of balance sheets, profit and loss, cash flow for the latest three FYs and stub period (if available) of the business/entity proposed to be acquired.
- Total unaudited information included in the CFS should not exceed 20 per cent of the turnover, net worth or profits before tax of the CFS of the respective year.

*(*A consolidated entity should be considered 'material' if it contributes 10 per cent or more to the turnover, net worth, or profits before tax in the annual CFS of the respective year.)*

ICDR Regulations, 2018 – Key changes



Other key changes

- The applicability threshold of ICDR Regulations, 2018 for rights issue has been increased from INR50 lakh to **INR10 crore**.
- For a company to be eligible to make a **fast track rights issue**, it should not have any audit qualifications in respect of FYs disclosed in the letter of offer.
- The time period for announcement of the price band has been reduced from five working days to **two working days** prior to the issue opening date.
- Shortfall of up to 10 per cent of minimum promoters' contribution may be met by prescribed institutional investors without being identified as promoters.

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Accounts of companies



Background

- On 3 January 2018, the Companies (Amendment) Act, 2017 (Amendment Act, 2017) received the assent of the President of India.
- Various provisions of the Amendment Act, 2017 would become effective at different dates.

New development

During the quarter ended September 2018, MCA notified some important sections of the Amendment Act, 2017 and amendments to the related rules under the 2013 Act. Key sections notified are as follows:

Amendments effective from

31 July 2018³

Financial statements and board's report (Section 134)



- **Approval of financial statements:** Financial statements of a company would be signed by:
 - a) Chairperson of the company (where he/she is authorised by the BoD), or two directors of which one would be managing director, **if any**
 - b) **Chief Executive Officer (CEO)** (earlier required only if CEO is a director)
 - c) Chief Financial Officer (CFO)
 - d) Company Secretary (CS).
- **Additional disclosures in the board's report (not being a small/one person company) regarding:**
 - Maintenance of cost records as specified by the CG.
 - Compliance with the provisions relating to the constitution of Internal Complaints Committee under the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013.

Managerial remuneration



12 September 2018⁴

Amendments effective from

Section 197, Schedule V to the 2013 Act and the Managerial Rules



Remuneration payable by companies with profits

- Company in a general meeting may authorise the payment of remuneration exceeding 11 per cent of the net profits of the company, subject to Schedule V to the 2013 Act (**removed CG approval requirement**).
- When there are one or more than one MD, WTD or manager in the company, approval of the shareholders **by a special resolution** is required to pay MR in excess of the maximum amount of remuneration prescribed.



Remuneration payable by companies with inadequate profits

- MR **in excess of limits specified in Schedule V (based on effective capital)** could be paid by passing a special resolution.



Default in payment of dues

- Where a company defaults in payment of dues to a bank/public financial institution/non-convertible debenture holders/any other secured creditor:
 - Prior approval of the bank/public financial institution/non-convertible debenture holders/other secured creditor, should be obtained before obtaining an approval in the general meeting for payment of MR.
- If a company plans to waive any excess managerial remuneration received which is refundable by a director, then an approval from bank/public financial institution/non-convertible debenture holders/other secured creditor is required.

Managerial remuneration (cont.)



Amendments effective from **12 September 2018**

Section 197, Schedule V to the 2013 Act and the Managerial Rules



Refund of excess remuneration

- Any excess remuneration should be refunded within **two years from the date it becomes refundable or such lesser period** as may be allowed by the company.
- Company is not allowed to waive the recovery of any sum refundable unless **approved by the special resolution within two years from the date the sum becomes refundable**.



Additional reporting in an auditor's report

- Report whether remuneration to directors is in accordance with law.
- Report whether remuneration paid to any director is an excess to the limit specified under Section 197.
- Other details as may be prescribed.



Applications pending with MCA

- Applications pending for approval of excess remuneration would abate.
- Companies should obtain shareholders' approval by a special resolution within one year from enforcement of amendments to Section 197.

Calculation of net profits (Section 198)



- **Net profits should additionally exclude** any amount representing unrealised gains, notional gains or revaluation of assets from the net profits.

Corporate Social Responsibility (CSR)



Amendments effective from **19 September 2018⁵**

Section 135 and the CSR Rules



- For determining the threshold of the specified net worth, turnover, or net profit to constitute a CSR committee, the words 'any FY' replaced by the words '**immediately preceding FY**'.
- Composition of the CSR committee for 'companies not required to appoint Independent Directors' changed to '**two or more directors**'.
- Section 135(3)(a) and the CSR Rules modified to refer to '**in areas or subjects specified in Schedule VII to the 2013 Act**' within which CSR activities could be undertaken by an eligible company.

Acceptance of deposits



15 August 2018⁶

Amendments effective from

Acceptance of deposits from public (Section 73 and the Deposit Rules)



- An amount not less than **20 per cent of the amount of deposits maturing during the following FY** should be kept in the deposit repayment reserve account (earlier 'not less than 15 per cent of the amount of its deposits maturing during a FY and the FY next following' was mentioned).
- Requirement to provide a **deposit insurance** has been **removed**.
- Companies which have made good on a default committed in the past would be allowed to accept deposits **after five years from the date of the default remediation**.
 - Certificate from a statutory auditor required for that default has not been committed. If a default is committed, company had made good the default and a period of five years has lapsed since the date of the default remediation.

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Amendments to Ind AS 20



- On 20 September 2018, MCA issued amendments to Ind AS 20 and other related Ind ASs⁷.
- Aligned to IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*.
- The amendments have been made effective from 1 April 2018 to be applied retrospectively as per Ind AS 8.

Overview of the amendments

Accounting for non-monetary government grants



- An alternate method for recognition and measurement of asset related grants:
 - Record both the asset and the grant **at a nominal amount** rather than at fair value.

Presentation of grants related to assets



- **In the balance sheet:**
 - Deduct the amount of grant to arrive at the carrying amount of the asset.
- **In the statement of profit and loss:**
 - Recognise the grant over the useful life of a depreciable asset as a reduced depreciation expense.

Repayment of government grants



- If the grant was previously deducted from the carrying amount of an asset, recognise:
 - Repayment of grant by increasing the carrying amount of the asset.
 - Cumulative additional depreciation to date in the statement of profit and loss.
- Additionally, consider possible impairment in the new carrying amount of the asset.



Q&A



Sources



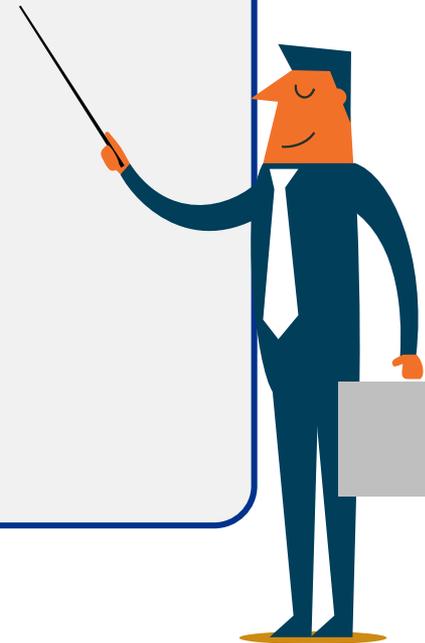
1. ICAI-ITFG clarification bulletin 16 dated 5 September 2018
2. SEBI notification no. SEBI/LAD-NRO/GN/2018/31 dated 11 September 2018.
3. MCA notification no. G.S.R. 725(E) and S.O. 3838(E) dated 31 July 2018
4. MCA notification dated 12 September 2018
5. MCA notification dated 19 September 2018
6. MCA notification no. S.O. 3300 (E) dated 15 August 2018
7. MCA notification dated 20 September 2018



Glossary



- 2013 Act - The Companies Act, 2013
- BoD - Board of Directors
- CFS - Consolidated Financial Statements
- CSR - Corporate Social Responsibility
- FVOCI - Fair Value through Other Comprehensive Income
- FVTPL - Fair Value through Profit or Loss
- ICAI - The Institute of Chartered Accountants of India
- ICDR Regulations - SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018
- IFRS - International Financial Reporting Standards
- IGAAP - Indian Generally Accepted Accounting Principles
- Ind AS - Indian Accounting Standards
- ITFG - Ind AS Transition Facilitation Group
- MCA - The Ministry of Corporate Affairs
- MLP - Minimum Lease Payment
- MR - Managerial Remuneration
- RPTs - Related Party Transactions
- SEBI - The Securities and Exchange Board of India



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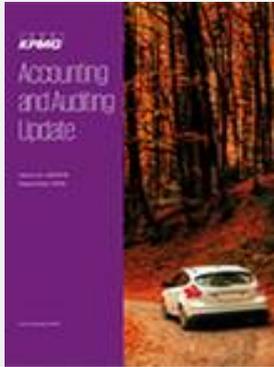


Month	Topics	Link
May 2018 (special session)	<ul style="list-style-type: none">• SEBI implements Kotak Committee recommendations	Click here
June 2018 (special session)	<ul style="list-style-type: none">• ICDS implementation issues	Click here
June 2018 (special session)	<ul style="list-style-type: none">• Ind AS implementation for NBFCs	Click here
July 2018	<ul style="list-style-type: none">• Notification of sections of the Companies (Amendment) Act, 2017 and related rules under the Companies Act, 2013• Amendments to SEBI Listing Regulations pursuant to Kotak Committee recommendations• Ind AS Transition Facilitation Group (ITFG) clarification - Bulletin 15	Click here
August 2018	<ul style="list-style-type: none">• Ind AS 115 - Sector Series 3	Click here
September 2018	<ul style="list-style-type: none">• Ind AS 115 - Sector Series 4	Click here

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