Voices on Reporting

7 January 2019

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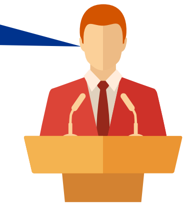
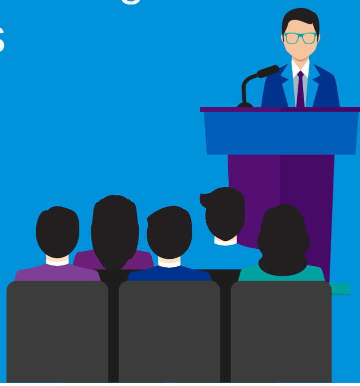
KPMG.com/in

Welcome



01

Series of knowledge sharing calls



02

Covering current and emerging reporting issues

03

Scheduled towards the end of each month

04

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

Speakers for the call

Gaurav Vohra

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KPMG in India

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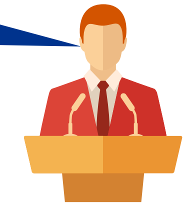
Agenda

1. **Ind AS Transition Facilitation Group (ITFG) clarification - Bulletin 17**
2. Amendments to the Companies Act, 2013 and key clarifications
3. Framework for fund raising by issue of debt securities by large corporates

Clarifications relating to government grants



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

X Ltd. (a government company) received land in the year 2008 to construct and operate a Mass Rapid Transit System (MRTS) in a metropolitan city. The land was received free of cost subject to compliance with specified terms and conditions. The land was recorded at a nominal value of INR1 as per applicable AS 12, *Accounting for Government Grants*.

As per recent amendments to Ind AS 20, an entity can either present the non-monetary asset and grant at fair value or record both asset and grant at a nominal amount.

Issue

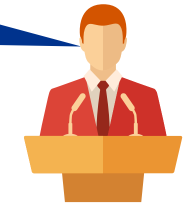
What would be the accounting treatment of such a land in the financial statements of X Ltd. in accordance with Ind AS 20?

Clarification[1]

Scenario 1: X Ltd. is a <u>first-time adopter</u> of Ind AS and its first Ind AS reporting period is <u>FY2018-19</u>

- As per Ind AS 101, *First-time Adoption of Indian Accounting Standards,* a first-time adopter of Ind AS is required to:
  - Prepare and present an opening Ind AS balance sheet at the date of transition to Ind AS
  - Use the same accounting policies in its opening Ind AS balance sheet and throughout all periods presented in its first Ind AS financial statements. Those accounting policies would comply with each Ind AS effective at the end of its first Ind AS reporting period.
- There is no mandatory/voluntary exemption from retrospective application of Ind AS 20 under Ind AS 101.
- Accordingly, X Ltd. would be required to apply the amended Ind AS 20 retrospectively for all periods presented in its financial statements for FY2018-19 (including in preparing its opening Ind AS balance sheet as at 1 April 2017).

Clarifications relating to government grants (cont.)



Scenario 2: X Ltd. is not a first-time adopter of Ind AS and FY2018-19 is its second (or third) reporting period under Ind AS

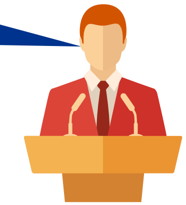
- Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors* requires an entity to **mandatorily** change an accounting policy **only if** the change:

  a) Is required by an Ind AS or

  b) Results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.

- Amendment to Ind AS 20 provides X Ltd., an accounting policy choice between recognising the grant and the asset initially either at fair value or at a nominal amount. Therefore, X Ltd. is not **mandatorily required** to change the accounting policy relating to the grant as applied by it in preparing its financial statements for the previous FY.
- X Ltd. could make a **voluntary** change in accounting policy only if such a change results in its financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on its financial position, financial performance or cash flows.

Clarifications relating to government grants (cont.)



2. Treatment of export benefits under a scheme of Government of India

MNC Ltd. (a registered unit in a Special Economic Zone (SEZ)) received benefits from the government in the form of exemption from payment of taxes and duties on import/export of goods subject to fulfilment of certain conditions.

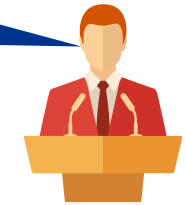
Issue

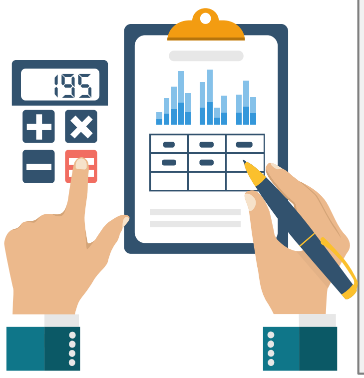
- Whether the benefit received by MNC Ltd. is a government grant or a government assistance other than government grant under Ind AS 20?
- If it is a government grant, then whether it would be accounted as a grant related to asset or grant related to income?

Clarification

- The benefit of *<u>exemption from payment of taxes and duties levied by the government</u>* is a government grant to be accounted as per the provisions of Ind AS 20.
- MNC Ltd. should exercise judgement and carefully examine the facts, objective and conditions attached to the scheme to determine whether the grant is related to an ‘asset’ or to ‘income’. Also ascertain the purpose of the grant and costs that are intended to be compensated for.
- MNC Ltd. should recognise the grant as below:
  - **Export of goods is a primary condition**: If the grant is received to compensate the import cost of assets, and is subject to export obligations, then the recognition of the grant would be linked to fulfilment of the associated export obligations and would be treated as grants related to income (to be presented as ‘other income’ or deducted from related expenses in the statement of profit and loss).
  - **Export of goods is a secondary condition**: If the grant is received to compensate the import cost of the asset, and it can be reasonably concluded that conditions relating to export of goods are subsidiary conditions, then such grant would be recognised as grant related to assets (to be presented as ‘deferred income’ over the life of the underlying asset).

Clarifications relating to financial instruments





1. Optionally convertible preference shares with discretionary dividend and an embedded call option

An entity K issued 12 per cent, five year, optionally convertible preference shares with discretionary non-cumulative dividend, at par in its functional currency. As per the terms of issue:

a) The holder of the preference shares had an option to convert them into fixed number of equity shares at the end of five years

b) If the conversion option was not exercised, the preference shares would be redeemed at par

c) Throughout the five year period, the holder had an option to put the preference shares back to entity K at its par amount.

Issue

What would be the accounting treatment of such preference shares in the financial statements of entity K?

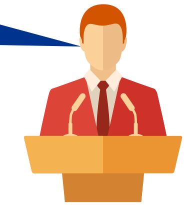
Clarification

- As per the terms of issue and guidance in Ind AS 32, *Financial Instruments: Presentation*, the economic effect of issuing the preference shares was substantially the same as issuing simultaneously a debt instrument with early settlement provision and warrants to purchase ordinary shares. Therefore, the components of the preference shares would be required to be classified and presented separately.
- Generally, the method to separate equity from liability in a compound instrument is fair value of the entire instrument less fair value of the liability. Residual is equity.
- In this case, since entity K has a contractual obligation to pay the par amount to the preference shareholder at any point in time, the liability component has a demand feature attached.

Clarifications relating to financial instruments (cont.)

- The fair value of a financial liability with a demand feature (e.g. a demand deposit) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid (refer to Ind AS 113, *Fair Value Measurement*).
- Accordingly, the whole of the issue price of the preference shares would be allocated to the liability component and nothing would be assigned to the equity component in this case.

Clarifications relating to financial instruments (cont.)



2. Issue of rights offer

An entity X, with INR as its functional currency had two classes of non-puttable equity shares - Class A and Class B. Post the date of transition to Ind AS, entity X made a rights offer to all holders of Class B equity shares. The terms of the right offer were:

- For each equity share of Class B held, the shareholder is entitled to subscribe to 100 equity shares of Class A
- The rights offer price was fixed at:
  - a) INR60 per Class A share for Indian shareholders, and
  - b) USD1 per Class A share for overseas shareholders
- The rights offer was valid for six months.

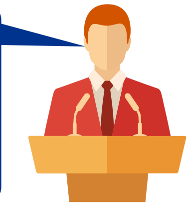
Issue

Whether from the perspective of entity X, the rights offer to Class B shareholders to acquire Class A shares was an equity instrument or a (derivative) financial liability?

Clarification

- As per Ind AS 32, a ‘financial liability’ is any liability that is a derivative that would or may be settled **other than** by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity’s own equity instruments.
- For this purpose, rights, options or warrants to acquire a fixed number of the entity’s own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments.

Clarifications relating to financial instruments (cont.)



- Accordingly, the terms of the rights issue have been evaluated as follows:
  - The rights offer was for acquiring a fixed number of the entity’s own equity instruments i.e. for each equity share of Class B held, the shareholder was entitled to subscribe to 100 equity shares of Class A
  - The right exercise price was a fixed amount i.e. INR60 per share for Indian shareholders and USD1 per share for overseas shareholders
  - Entity X had made the rights offer to all the existing shareholders of Class B equity shares pro-rata to their holding of Class B equity shares.
- Since all the conditions for equity classification are met in the given case, the rights offer to Class B shareholders to acquire Class A shares would be classified as an equity instrument.

Clarifications relating to financial instruments (cont.)

3. Preference shares issued in foreign currency

An entity Y, with INR as its functional currency, issued preference shares with three years term denominated in a foreign currency to an overseas investor. At the end of three years, entity Y had an option to either redeem each preference share at USD10 or get it converted into three equity shares of entity Y.

Issue

Whether entity Y should classify the equity conversion option forming part of terms of issue of preference shares as an equity instrument or a (derivative) financial liability?

Clarification

- As per Ind AS 32, a derivative would be classified as a financial liability if it will or may be settled other than by the exchange of a *fixed amount of cash* or another financial asset for a fixed number of the entity's own equity instruments.
- The term 'fixed amount of cash' referred to an amount of cash fixed in the functional currency of the reporting entity.
- An amount fixed in a foreign currency has the potential to vary in terms of functional currency of the reporting entity due to exchange rate fluctuations, therefore, it does not represent a 'fixed amount of cash'.
- As an exception, Ind AS 32 regards an equity conversion option embedded in a convertible bond denominated in a foreign currency to acquire a fixed number of the entity's own equity instruments to be an equity instrument if the exercise price was fixed in any currency (i.e. functional or foreign currency).
- The above exception cannot be extended to equity conversion options embedded in other types of financial instruments denominated in a foreign currency such as preference shares.
- Therefore, in the given case, the equity conversion option forming part of terms of issue of preference shares would be a (derivative) financial liability of entity Y.

Inclusion of DDT on preference shares in EIR

ABC Ltd. had issued cumulative redeemable preference shares carrying a fixed rate of dividend per annum. The preference shares are redeemable at a specified premium at the end of eight years from the date of their issue.

On the basis of terms and conditions of issue, ABC Ltd. determined that the preference shares would qualify for classification as a financial liability in their entirety under Ind AS 32.

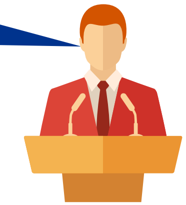
Issue

In case preference shares are accounted for in accordance with Ind AS 109, *Financial Instruments*, would Dividend Distribution Tax (DDT) on such shares be included in computing Effective Interest Rate (EIR) thereon?

Clarification

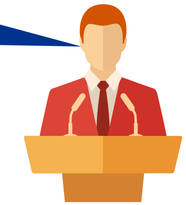
- As per Ind AS 32, if a financial instrument is classified as a financial liability in its entirety (similar to the instant case), the 'dividend' thereon is in the nature of interest and is accordingly, charged to the statement profit and loss.
- Ind AS 109 provides that when applying the EIR method, an entity generally amortises any fees, points paid or received, transaction costs and other premiums or discounts that are included in the calculation of EIR over the expected life of the financial instrument.
- Guidance Note on Division II - Ind AS Schedule III to the 2013 Act and FAQs issued by the ICAI provides following guidance:
  - Dividend on preferences shares (whether redeemable or convertible) is of the nature of 'interest expense', only where there is no discretion of the issuer over the payment of such dividends. In such a case, the portion of dividend as determined by applying the EIR method should be presented as 'interest expense' under 'finance cost'. The corresponding DDT on such portion of non-discretionary dividends should also be presented in the statement of profit and loss under 'interest expense'.
  - Presentation of DDT paid on the dividends should be consistent with the presentation of the transaction that creates those income tax consequences. Therefore, DDT should be charged to profit or loss, if the dividend itself is charged to profit or loss.

Inclusion of DDT on preference shares in EIR (cont.)



- In the given case, the preference shares have been classified as a liability in their entirety and dividend thereon is therefore, considered to be in the nature of interest.
- The related DDT should be regarded as part of interest cost and should form part of EIR calculation.

Equity accounting in the CFS of investor in case of loss of control



B Ltd. (subsidiary of A Ltd.), owned an investment property that was measured at cost in accordance with Ind AS 40, *Investment Property*. A Ltd. sold a portion of its equity shareholding in B Ltd., and consequently, B Ltd. became a joint venture between A Ltd. and another entity Z Ltd.

As per Ind AS 28, *Investments in Associates and Joint Ventures*, equity method is required to be applied in the CFS of A Ltd. to account for its investment in the joint venture (i.e. B Ltd.).

Ind AS 40, on the other hand, does not allow an investment property to be measured at fair value.

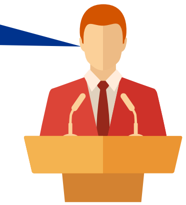
Issue

- Whether there is any contradiction between Ind AS 40 and Ind AS 28?
- Whether the adjustments arising out of fair valuation of investment property as required under Ind AS 28 should be made in the CFS of the investor?

Clarification

- Ind AS require the application of a mixed measurement model.
- As per Ind AS 110, *Consolidated Financial Statements,* if a parent loses control of a subsidiary, it recognises any investment retained in the former subsidiary at its fair value when control is lost. Such fair value is regarded as the cost on initial recognition of an investment in a joint venture (or an associate).
- On acquisition of controlling interest in an entity (or an interest giving the investor joint control or significant influence over the investee), Ind AS requires the investor to identify:
  - A bargain purchase gain or
  - Goodwill.
- The amount of any bargain purchase gain or of any payment for goodwill would be determined with reference to the fair values of the identifiable assets and liabilities of the investee as at the acquisition date and not with reference to their book values as at that date. (Refer Ind AS 103, *Business Combinations* and Ind AS 28)

Equity accounting in the CFS of investor in case of loss of control (cont.)



- There is no contradiction between Ind AS 28 and other standards that require a cost-based measurement in the balance sheet of the investee.
- Adjustments would arise out of fair valuation of assets/liabilities that would impact profit or loss and would be recognised in the CFS of the investor.

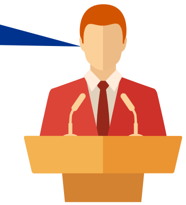
Agenda

1. Ind AS Transition Facilitation Group (ITFG) clarification - Bulletin 17

2. Amendments to the Companies Act, 2013 and key clarifications

3. Framework for fund raising by issue of debt securities by large corporates

Amendments to Schedule III to the 2013 Act



- The MCA through its notification dated 11 October 2018 has amended Schedule III to the 2013 Act[2].
- Key amendments made in the respective division of Schedule III are as follows:

Division I (Applicable to companies following AS)

In the **balance sheet and** related **notes** section:

- The term ‘fixed assets’ has been changed to **‘property, plant and equipment’**
- The term ’securities premium reserve’ has been changed to **‘securities premium’.**

Division II (Applicable to companies required to follow Ind AS (other than NBFCs)

- **Trade payables** to be further categorised into:
  - a) Total outstanding dues to micro enterprises and small enterprises and
  - b) Total outstanding dues to creditors other than micro enterprises and small enterprises.
- **Trade/loan receivables** to be classified as follows:
  - a) Trade/loan receivables considered good - Secured
  - b) Trade/loan receivables considered good - Unsecured
  - c) Trade/loan receivables which have significant increase in credit risk and
  - d) Trade/loan receivables - credit impaired.
- Disclose **purpose of each reserve** included within ‘other equity’ in the notes to the statement of changes in equity.

Amendments to Schedule III to the 2013 Act (cont.)

Division III – Newly inserted

Applicability

- Applicable to every NBFC to which Ind AS applies in preparation of financial statements.

Balance sheet

- Items presented to be classified as **'financial'** and **'non-financial'.**
- NBFCs are permitted to present assets and liabilities in order of liquidity.
- Disclosure relating to derivative financial instruments and subordinated liabilities to be made on the face of the balance sheet.

Statement of profit and loss

- Disclose items comprising 'revenue from operations' and 'other comprehensive income' on the face of the statement of profit and loss.
- Disclose a note for any item of 'other income' or 'other expenditure' which **exceeds one per cent of the total income.**

Statement of changes in equity

- Disclose statutory reserves as part of 'other equity'.
- Disclose separately conditions or restrictions for distribution attached to statutory reserves.

Applicability date of formats for presentation of financial results - A clarification

- On 22 November 2018, the NSE Ltd. and BSE Ltd. through a circular[3] clarified the applicability date of the notification on amendments to Schedule III for listed entities.
- As per the clarification:

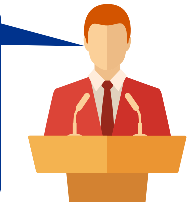
For the quarter ended 31 December 2018

- Follow existing formats of the Schedule III.
- In addition to the existing formats, entities may submit financial results as per the new format (amended Schedule III).

For the quarter/year ending on or after 31 March 2019

- All entities (including NBFCs) should present quarterly and annual financial results as per the new formats (amended Schedule III).

Disclose reasons for delay in submission of financial results- A clarification



Current requirement

- Regulation 33(3) of the Listing Regulations prescribe following timelines for submission of financial results with the stock exchange by an **equity listed entity:**
  - **Quarterly and year to-date separate and consolidated financial results:** Within 45 days of the end of each quarter, other than the last quarter.
  - **Annual separate and consolidated financial results along with last quarter results:** Within 60 days from the end of the FY.

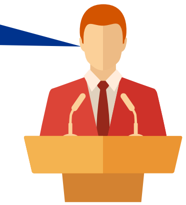
SEBI clarification

On 19 November 2018, SEBI issued a circular[4] and provided the following clarification:

Effective from 19 November 2018

- A listed entity which does not submit its financial results within the above mentioned timelines would be required to disclose the detailed reasons for such delay to the stock exchanges **within one working day of the due date** of submission for the results.
- If the decision to delay the results was taken prior to the due date of submission of financial results, then it should disclose detailed reasons for such delay **within one working day of such decision.**

The Companies (Amendment) Ordinance, 2018



- On 2 November 2018, the Ministry of Law and Justice issued the Companies (Amendment) Ordinance, 2018 (ordinance)[5].
- The ordinance amended the 2013 Act based on the recommendations of the committee formed to review the existing framework dealing with the offences under the 2013 Act.

Key amendments are as follows:

Effective from 2 November 2018

Declogging of the Tribunal

Power vested with the **CG** (instead of Tribunal) to approve:

- Changes to the financial year and
- Alteration of articles pursuant to conversion of public companies into private companies.

Revised eligibility criteria for appointment of a director

- A person would not be eligible to be appointed as a director of a company if he/she holds office as a director (including any alternate directorship) in more than 20 companies at the same time (of which directorship in public companies should not exceed 10).

Penalty for repeated default

- In case a company/an officer/any other person is subject to penalty for default under any provisions of the 2013 Act and commits such default again **within a period of three years** from the date of order imposing such penalty passed by the adjudicating officer/regional director, then:
  - *For the second or subsequent defaults:* Such a person would be liable for an amount equal to **twice the amount of penalty** provided for such default under the relevant provisions of the 2013 Act.

The Companies (Amendment) Ordinance, 2018 (cont.)

Replacement of fine with penalty

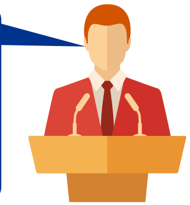
- Certain amendments to the penal provisions have replaced fines with penalties.
- Some of the key situations where fines have been replaced with penalties are as follows:
  - Failure to file an annual return within the stipulated period
  - Failure to file copy of financial statements with the ROC
  - Non-compliance with the provisions relating to appointment of directors and intimation of DIN
  - Non-compliance with the norm relating to maximum number of directorships
  - Non-compliance with the provisions relating to appointment of KMP.

The changes brought by the ordinance have been introduced in the Lok Sabha as the Companies (Amendment) Bill, 2018[6].

Agenda

1. Ind AS Transition Facilitation Group (ITFG) clarification - Bulletin 17
2. Amendments to the Companies Act, 2013 and key clarifications
3. **Framework for fund raising by issue of debt securities by large corporates**

Framework for fund raising by issue of debt securities by large corporates

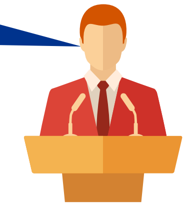


- On 26 November 2018, SEBI issued a circular[7] and provided a framework comprising detailed guidelines for raising of funds by issuing debt securities.
- Key requirements prescribed are as follows:

Minimum borrowings from debt securities	• All listed entities (except scheduled commercial banks) classified as 'large corporates' are mandatorily required to raise **at least 25 per cent of their incremental borrowings during a FY** (subsequent to the FY in which it is identified as a large corporate) by issuing debt securities.
Large corporate	• A listed entity would be classified as a **large corporate** if it meets all of the following: a) Its specified securities*, debt securities or non-convertible redeemable preference share are listed on a recognised stock exchange(s) in terms of Listing Regulations b) It has an outstanding long-term borrowing of INR100 crore or above and c) It has a credit rating of 'AA and above'.

*(*Specified securities means 'equity shares' and 'convertible securities'.)*

Framework for fund raising by issue of debt securities by large corporates (cont.)



Effective date

- **For the entities following April-March as FY:** 1 April 2019
- **For the entities following calendar year as FY:** 1 January 2020.

Accordingly,

- **For FY2020 and 2021**: The requirement of meeting the incremental borrowing norms would be applicable on an annual basis. Identify large corporate as on 31 March 2019/31 March 2020 and comply with the requirement by 31 March 2020 and 31 March 2021.

  In case of shortfall in borrowing, an explanation to be provided to the stock exchange(s).

- **From FY2022**: The requirement of mandatory incremental borrowing to be met over a contiguous block of two years. Identify large corporate on the last day of FY ‘T-1’ and fulfill the incremental borrowing requirement for FY ‘T’ over FY ‘T’ and FY ‘T+1’.

  In case of shortfall at the end of two years, monetary penalty/fine of 0.2 per cent of the shortfall in the borrowed amount would be levied.

Disclosures by a large corporate to the stock exchange(s)

- Fact that it has been identified as a large corporate should be disclosed in the specified format within 30 days from the beginning of the FY and
- Details of the incremental borrowings done during a FY in the specified format within 45 days of the end of the FY.

The above disclosures would also form part of the audited annual financial results of the listed entity.

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Q&A

Sources

1. ICAI-ITFG clarification bulletin 17 dated 19 December 2018
2. MCA notification dated 11 October 2018.
3. NSE circular no. NSE/CML/2018/32 and BSE circular no. LIST/COMP/27/2018-19 dated 22 November 2018.
4. SEBI circular no. CIR/CFD/CMD-1/142/2018 dated 19 November 2018.
5. Companies (Amendment) Ordinance, 2018 issued by Ministry of Law and Justice on 2 November 2018.
6. Companies (Amendment) Bill, 2018 as introduced in Lok Sabha on 20 December 2018.
7. SEBI circular no. SEBI/HO/DDHS/CIR/P/2018/144 dated 26 November 2018.

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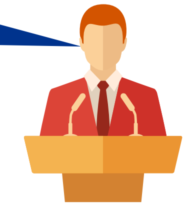
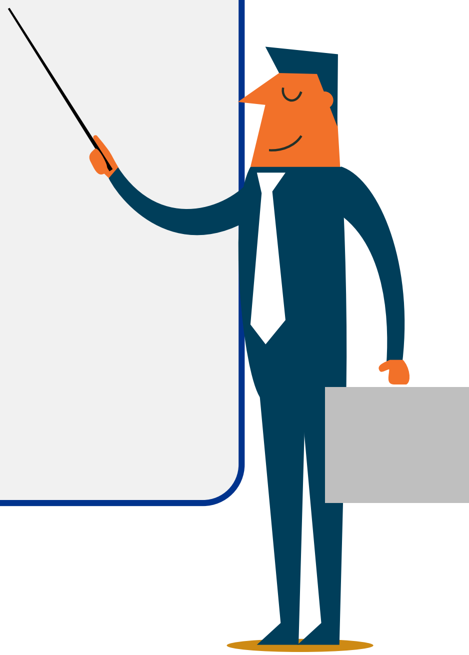
Glossary



- 2013 Act - The Companies Act, 2013
- AS - Accounting Standard
- BoD - Board of Directors
- CFS - Consolidated Financial Statements
- CG - Central Government
- DIN - Director Identification Number
- FVOCI - Fair Value Through Other Comprehensive Income
- FVTPL - Fair Value Through Profit and Loss
- FY - Financial Year
- ICAI - The Institute of Chartered Accountants of India
- Ind AS - Indian Accounting Standards
- KMP - Key Managerial Personnel
- MCA - The Ministry of Corporate Affairs
- NBFC - Non-Banking Financial Companies
- NSE Ltd. - National Stock Exchange Ltd.
- RPT - Related Party Transaction
- SEBI - The Securities and Exchange Board of India



Links to previous recordings of VOR

Month	Topics	Link
August 2018 (special session)	Ind AS 115 – Sector Series 3 – *Automotive Sector*	Click here
September 2018 (special session)	Ind AS 115 – Sector Series 4 – *Consumer and retail sector*	Click here
October 2018	• Ind AS Transition Facilitation Group (ITFG) clarification - Bulletin 16 • SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 • Certain sections of the Companies (Amendment) Act, 2017 and related rules notified • Amendments to Ind AS 20, *Accounting for Government Grants and Disclosure of Government Assistance.*	Click here
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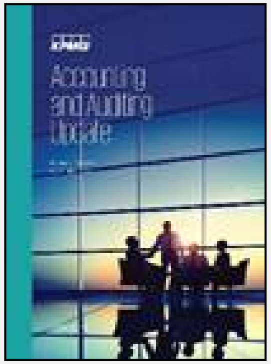
Accounting and Auditing Update



First Notes

Coming up next

New issue of:

- Accounting and Auditing Update
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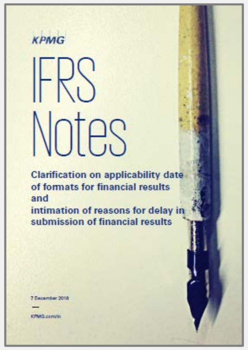

Thank you

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