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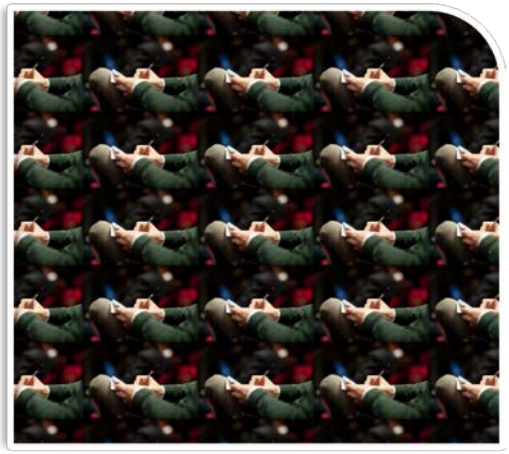
cutting through complexity

Voices on Reporting

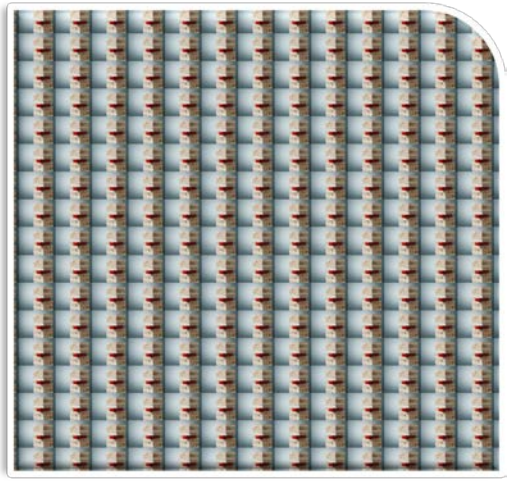
20 May 2015

Welcome



Series of knowledge sharing calls

Covering current and emerging reporting issues



Scheduled towards the end of each month

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

Your speaker

Nirav Patel
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KPMG in India

Agenda

1. **Background: Ind AS and implementation roadmap**
2. Salient features of Ind AS 16, *Property, Plant and Equipment and* Ind AS 38, *Intangible Assets*
3. Key differences between AS 10, AS 26, Ind AS 16 and Ind AS 38
4. Key aspects of application guide issued by the Institute of Chartered Accountants of India (ICAI)

Background: Ind AS and implementation roadmap

The MCA on 16 February 2015 issued 39 Indian Accounting Standards (Ind AS)

Ind AS refers to accounting standards which provide IFRS convergence in India; these standards incorporate IFRS with certain key carve-outs

Ind AS mandatorily applicable to prescribed classes of companies from FY 2016-17

For other prescribed class of companies, mandatorily applicable from FY 2017-18

Voluntary adoption permitted from FY 2014-15 onwards; no rollback permitted

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Salient features of Ind AS 16, *Property, Plant and Equipment* and Ind AS 38, *Intangible Assets*

Definitions

Controlled by the entity

Expected future economic benefits

Expected to be used > 1 period

Held for production, rental, administrative use

Identifiable asset without physical substance

Start up costs or pre-operative expenses often are capitalised in India. Under Ind AS, these are specifically excluded from capitalisation.

Source – KPMG in India's analysis

Salient features of Ind AS 38, *Intangible Assets*

What is identifiable?

- Arises from contractual/other legal rights
- Is separable

Implication: Market share of a company does not meet the definition of an asset because it is not separable and it does not give rise to legal rights

What is control?

- Power to obtain future economic benefits
- Restrict access of others to benefits

Recognition

- Probable future economic benefits
- Cost can be measured reliably

Salient features of Ind AS 16, *Property, Plant and Equipment* and Ind AS 38, *Intangible Assets*

Measurement at cost

Cost means expenditure directly attributable to bringing an asset to the location, and condition necessary for intended use

Part of cost - Import duty, dismantling and removal costs, borrowing costs on qualifying asset

Not part of cost - Feasibility assessment costs, costs of staff training, administration and overhead costs.

Subsequent expenditure

Subsequent expenditure is recognised as part of an asset cost only if it meets the general recognition criteria - i.e. it is probable that future economic benefits associated with the item will flow to the entity and the cost of the item can be measured reliably.

Examples of cost

- Brokerage cost
- Demolition cost
- Relocation cost
- Operating lease during construction period/major refurbishment period
- Trial run
- Modification cost
- Cancellation fees
- Abnormal waste
- Decommissioning cost
- Deferred credit terms

Depreciation/amortisation

Principles of depreciation/amortisation

- Systematic allocation of cost to the statement of profit and loss over useful life
- Amount determined after deducting residual value
- Changes are to be considered changes in estimates
- Review of key assumptions at least at each reporting date

Amortisation

Useful life

- Finite
- Might be indefinite

Factors in assessing useful life

- Expected usage, life cycles, obsolescence, industry
- Periods of control and legal limits
- Contractual terms and renewal periods

Indefinite-lived intangible assets

- No foreseeable limit on period of cash inflows
- Planned future expenditure other than to maintain standard is not included
- Indefinite does not mean infinite

Salient features of Ind AS 16, *Property, Plant and Equipment* and Ind AS 38, *Intangible Assets*

Component accounting

- Item consists of individual components
- Depreciation method/useful life different for each component
- Components can be physical (parts) or non-physical (e.g. overhaul costs)
- Components significant in relation to total cost of an item

Measurement model

Cost model or revaluation model

- Some conditions
- Severe restrictions

Cost model

Cost
Less: Depreciation/amortisation
Less: Impairment losses

Revaluation model

Revalued amount
Less: Depreciation/amortisation
Less: Impairment losses

Ind AS 101, *First- time Adoption of Ind AS*

- **The objective of Ind AS 101 is to:**
  - provide a suitable starting point for accounting in accordance with Ind AS
  - set out the procedures to be followed by entities for adoption of Ind AS
- PPE/intangible assets
  - This optional exemption permits the carrying amount of an item of PPE/intangible assets to be measured at the date of transition based on a deemed cost.
  - If it is elected, then the deemed cost exemption may be based on any of the following:
    - Fair value
    - A revaluation that was broadly on a basis comparable to fair value under Ind AS
    - An event-driven valuation
    - Continue with Indian GAAP carrying values as 'deemed cost' for PPE/intangible assets acquired prior to transition date

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Key differences between AS 10, AS 26, Ind AS 16 and Ind AS 38

Capitalisation of administrative and general overheads	
Current guidance permits capitalisation of these costs provided they are specifically attributable to construction of a project, to the acquisition of a fixed asset or bringing it to its working condition. Start-up costs or pre-operative expenses end up being capitalised.	Ind AS specifically excludes these costs from being capitalised and require it to be charged to the statement of profit and loss in the year in which they incur.

Revaluations	
• Fixed assets may be revalued • Revaluation approach is ad hoc. It is not mandatory to revalue the entire class at the same time. Selection of assets for revaluation can be made on a systematic basis • There is no requirement of keeping revaluations upto date.	• PPE whose fair value can be measured reliably may be revalued to fair value • If an asset is revalued then all PPE of the same class must be revalued at the same time. A class of assets is a grouping of items that have a similar nature and use in an entity's operations • The revaluations must be kept upto date.

Key differences between AS 10, AS 26, Ind AS 16 and Ind AS 38

Deferred payment for acquisition/disposal	
No such adjustment is made	Payment deferred beyond normal credit terms should be recognised as interest expense over the period of credit unless it is capitalised as per Ind AS 23, *Borrowing Costs*.

Indefinite useful lives for certain intangible assets	
There is a rebuttable presumption that the useful life can not exceed 10 years from the date the asset is available for use. If the presumption is rebutted, useful life of an intangible asset can not be indefinite.	Useful life of an intangible asset can even be indefinite subject to fulfilment of certain conditions, in which case it should not be amortised but should be tested for impairment annually and whenever there is an indication that the intangible asset may be impaired.

Key differences between AS 10, AS 26, Ind AS 16 and Ind AS 38

Restriction on revenue-based amortisation	
AS 26 requires minimum amortisation as per straight-line method • There will rarely, if ever, be persuasive evidence to support an amortisation method for intangible assets that results in a lower amount of accumulated amortisation than under the straight-line method. • Schedule II to the Companies Act, 2013 permits revenue based amortisation in case of intangible assets (toll roads) created under BOT/ BOOT, etc.	• No requirement for minimum amortisation • Revenue-based amortisation is permitted only in limited circumstances: (a) in which intangible asset is expressed as a measure of revenue; or (b) when it can be demonstrated that revenue and consumption of economic benefits of intangible assets are highly correlated. • In addition, Ind AS 101 provides a voluntary exemption to continue accounting as per previous GAAP for amortisation of intangible assets arising from service concession arrangements related to toll roads recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period

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Key aspects of application guide issued by the Institute of Chartered Accountants of India (ICAI)

Shift in approach for depreciation calculation

The Companies Act, 1956

- Depreciation to be systematically allocated over useful life as per AS
- Minimum rates of depreciation to be provided by a company
- If management's estimate is higher at the time of acquisition and remaining useful life or remaining useful life on a subsequent review is shorter than the Schedule XIV, depreciation was provided at higher rate
- Residual value should not exceed five per cent of the original cost.

The Companies Act, 2013

- Part C of the Schedule II lays down indicative useful lives
- Useful life should not be different from the Part C of the Schedule II
- Residual value should not exceed five per cent of the original cost
- On adoption of different useful life/residual value, disclosure of such difference and justification in the financial statements supported by technical advice is required.

Application guide

- Determination of useful life of assets is a matter of judgement/estimation
- Maintain adequate details about the technical assessment of the useful lives
- Factors for determining the useful life have been provided in the application guide
- Useful life of an asset could be shorter than its economic life based on the asset management policy
- Possible effects of future price-level changes (i.e. inflation) in estimating residual value should not be considered
- Electricity companies should continue to charge depreciation in accordance with the Electricity Act.

Key aspects of application guide issued by the ICAI

Component approach

The Companies Act, 2013	Application guide
• Depreciation for significant components should be determined separately • Mandatory from 1 April 2015.	• Determination of significant components requires careful assessment of facts • Following factors to be assessed at the minimum: - comparison of the cost allocated to the item to the total cost of the aggregated PPE and - consideration of potential impact of componentisation on the depreciation expense • Factors for determining cost of component are given • Consider impact on retained earnings, current year and future profit or loss for determining materiality • Involve technical experts to determine the parts of an asset.

Key aspects of application guide issued by the ICAI

Depreciation in case of double/triple shift

The Companies Act, 1956

- Different rates of depreciation for assets used under single/ double/triple shifts prescribed under the Schedule XIV
- For example, for general plant and machinery, rates prescribed are 4.75 per cent, 7.42 per cent and 10.34 per cent respectively.

The Companies Act, 2013

- Part C to the Schedule II does not prescribe separate rates/lives for assets working on extra shifts
- If an asset is used in double shift, depreciation will increase by 50 per cent or by 100 per cent in case of triple shift.

Application guide

- The Schedule II does not treat each shift as a single unit of account
- Depreciation includes impact due to efflux of time, obsolescence of technology and number of shifts used by companies could vary
- If management determines lower life than Schedule II, depreciate as per lower life as required by AS 6
- If management determines higher life than Schedule II, longer life is permitted with justification based on technical advice.

Key aspects of application guide issued by the ICAI

Depreciation on revalued assets

The Companies Act, 1956	The Companies Act, 2013	Application guide
The ICAI's Guidance Note on Treatment of Reserve created on Revaluation of Fixed Assets permits an amount equivalent to the additional depreciation on account of the upward revaluation of fixed assets to be transferred from the revaluation reserve to the statement of profit and loss.	• Depreciation to be provided on historical cost or amount substituted for the historical cost • Depreciation on the revalued amount to be charged to the statement of profit and loss.	• Accounting treatment given in the guidance note may not apply • Transfer of a portion of revaluation reserve to general reserve is permitted • The amount of the revaluation reserve transferred would be the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on its original cost.

Key aspects of application guide issued by the ICAI

Full depreciation on assets below certain threshold

The Companies Act, 1956	The Companies Act, 2013	Application guide
• 100 per cent depreciation of the cost of an asset having individual value of INR5,000 or less was allowed under the Schedule XIV • On the basis of materiality of the financial impact of such charge.	100 per cent depreciation of the cost of an asset having individual value of INR5,000 or less has not been carried forward in the Schedule II.	• Materiality of the impact of such charge should be considered with reference to the cost of asset • A company may have a policy to fully depreciate assets up to certain threshold limits considering materiality aspect in the year of acquisition.

Links to previous recordings of Voices on Reporting

Voices on Reporting

Month	Topics	Link
April 2014	• Companies Act – Implementation questions • SEBI corporate governance norms	Click here
May 2014	• Companies Act - Matters for first board and general meetings • ICAI's roadmap for adoption of Ind AS	Click here
June 2014	Companies Act, 2013 – clarifications issued by the Ministry of Corporate Affairs (MCA)	Click here
July 2014	Tax accounting standards – implementation challenges	Click here
August 2014	Related party transactions – the Companies Act, 2013	Click here
September 2014	• Recent amendments in tax audit forms • Key amendments to clause 49 of the Equity Listing Agreement	Click here
November 2014	• Exposure draft on Ind AS 101, First time adoption of Indian Accounting Standards • Probable benefits and challenges of Ind AS conversion	Click here
January 2015	• Ind AS implementation roadmap • Revised drafts on Income Computation and Disclosure Standards (ICDS)	Click here

Links to previous recordings of Voices on Reporting

Voices on Reporting

Month	Topics	Link
February 2015	• Overview of Income Computation and Disclosure Standards (ICDS) • Significant impact areas of ICDS • Next steps for ICDS implementation	Click here
March 2015	• Overview of Section 143(12) of the Companies Act, 2013 • Persons covered for reporting under Section 143(12) of the Companies Act, 2013 • Reporting on frauds in various scenarios	Click here
April 2015	• Overview of key changes and implementation challenges for companies that adopt ICDS from this year • Overview of the financial reporting and regulatory developments introduced under the Indian GAAP during the year ended 31 March 2015.	Click here

Q&A

KPMG in India's IFRS Institute – Re-launched

KPMG in India is pleased to re-launch 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 on the evolving global financial reporting framework.

In addition to proprietary KPMG content, the website provides links to several other sources of information related to IFRS and its implementation. The site can be accessed by all interested parties at no cost. Additionally, the site provides the facility to register as a member by providing certain minimal information.

To download KPMG content, become registered members of the website following few easy steps.
https://www.in.kpmg.com/IFRS

You can reach us for feedback and questions at
in-fmkpmgifrsinst@kpmg.com

Sources

1. Indian Accounting Standard (Ind AS) 16, *Property, Plant and Equipment* issued by the Ministry of Corporate Affairs (MCA).
2. Indian Accounting Standard (Ind AS) 38, *Intangible Assets* issued by the Ministry of Corporate Affairs (MCA).
3. Accounting Standard (AS) 10, *Accounting for Fixed Assets* issued by the Institute of Chartered Accountants of India (ICAI).
4. Accounting Standard (AS) 26, *Intangible Assets* issued by the Institute of Chartered Accountants of India (ICAI).
5. Accounting Standard (AS) 6, *Depreciation Accounting* issued by Institute of Chartered Accountants of India (ICAI).
6. Application guide on the provisions of Schedule II to the Companies Act, 2013 issued by the Institute of Chartered Accountants of India (ICAI).

Introducing IFRS Notes

Voices on Reporting

Issue 2015/02

The IASB proposes to defer the effective date of the new revenue standard

On 28 April 2015, the International Accounting Standards Board (IASB) voted to publish an exposure draft (ED) proposing a one-year deferral of the effective date of the revenue standard to 1 January 2018.

The IASB and FASB Joint Transition Resource Group have discussed a number of application issues and some companies have called for more time to implement the new requirements, due to the significance of the changes they may face and the complexity of the IT solutions needed. The U.S. Financial Accounting Standards Board (FASB) has voted to propose a one-year deferral of the effective date of the standard earlier in April 2015. Accordingly, the IASB is planning to issue an ED with proposed clarifications to the standard as well as to keep the effective date of the IASB's and the FASB's revenue standard aligned.

The IASB will consult on the proposed deferral of the effective date by one-year before it is confirmed, as it is required by its due process. Early application of the standard would, however, still be permitted.

Topics discussed in AAU and First Notes

Accounting and Auditing update

May 2015

- The ICAI provides guidance on provisions relating to depreciation under the Companies Act, 2013
- Accounting of investment property
- Share application money – accounting and disclosures
- Guidance note on accounting for rate regulated activities
- Disclosure of discounts while presenting revenue
- Proposals for changes to accounting for income taxes under U.S. GAAP
- Regulatory updates

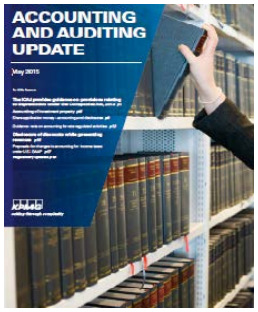
First Notes

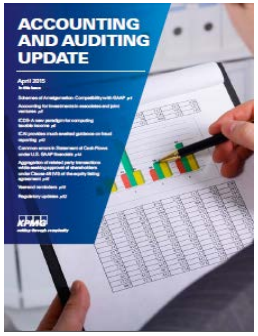
The ICAI issues guidance note on accounting for derivative contracts

There has been some lack of guidance on the accounting for derivative contracts and hedging activities. In order to bring uniformity of practice in accounting for derivative contracts by various entities in India, on 12 May 2015, the ICAI issued a guidance note of accounting for derivative contracts (guidance note). This guidance note provides guidance on recognition, measurement, presentation and disclosure for derivative contracts. The guidance note does not deal with macro-hedging and accounting for non-derivative financial assets/liabilities which are designated as hedging instruments since its objective is to provide guidance on accounting for derivative contracts only and not hedge accounting in its entirety. It becomes applicable for accounting periods beginning on or after 1 April 2016. Early voluntary adoption is encouraged.

Others

Missed an issue of the Accounting and Auditing Update?





Missed an issue of the First Notes?

Download from www.kpmg.com/in

Coming up next

June 2015

New issue of:

- **Accounting and Auditing Update**
- **First Notes**
- **IFRS Notes**

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Thank you

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

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