Voices on Reporting

18 November 2015

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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 speakers

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Agenda

- Overview of Ind AS 109, *Financial Instruments*
- Draft Interpretations on IAS 12, *Income Taxes* and IAS 21, *The Effects of Changes in Foreign Exchange Rates*

Overview of Ind AS 109[1]

- **Introduction**
- Classification
- Measurement
- Key differences between Indian GAAP and Ind AS 109

Overview of the standards on financial instruments

Ind AS 32, *Financial Instruments: Presentation*

- Liability vs equity classification
- Offsetting

Ind AS 109, *Financial Instruments*

- Classification and measurement
- Derivatives
- Recognition and derecognition
- Hedge accounting

Ind AS 107, *Financial Instruments: Disclosures*

- Disclosures

Overview of Ind AS 109[1]

- Introduction
- **Classification**
- Measurement
- Key differences between Indian GAAP and Ind AS 109

Classification: Financial assets

Measurement categories

- The measurement categories are as follows:

Ind AS 109	Removes existing categories of AS 30/IAS 39
FVTPL[1] Amortised cost FVOCI[3]	FVTPL Loans and receivables/HTM[2] AFS[4]

- Significant changes in criteria for classifying assets.

Reclassification of financial assets is subject to strict conditions and is expected to be very infrequent.

[1]FVTPL - Fair value through profit or loss
[3]FVOCI - Fair value through other comprehensive income
[2]HTM - Held to maturity
[4]AFS - Available for sale

Classification: Financial liabilities

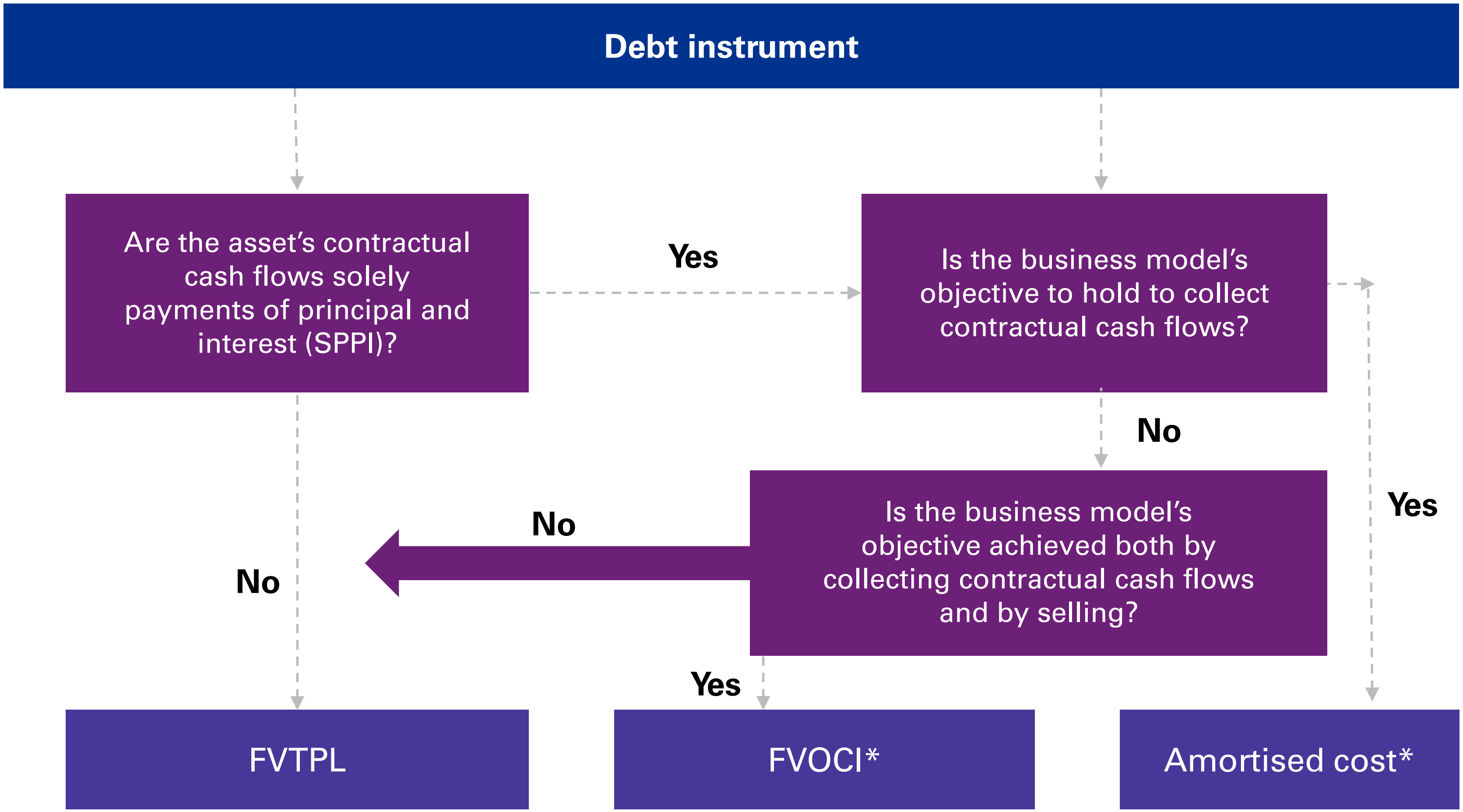
Measurement categories

- Classified as measured at amortised cost or at FVTPL.
- Presentation in OCI* of gain or loss on a financial liability designated at FVTPL attributable to changes in own credit risk.

Reclassification of financial liability – not permitted.

*OCI - Other comprehensive income

Classification of financial assets: Debt instruments



* Subject to FVTPL designation option - if it reduces accounting mismatch

The SPPI criterion

Do the cash flows consist only of principal and interest?

Consistent with a basic lending arrangement.

Particulars	Definition
Principal	Fair value of asset on initial recognition.
Interest	Consideration for: time value of money; credit risk; other basic lending risks (such as liquidity risk); other associated costs (such as administrative costs); and a profit margin.

Business models overview

Business models	Key features	Measured at
Held-to-collect contractual cash flows	• Objective: hold assets to collect contractual cash flows. • Sales are incidental to the objective. • Typically lowest sales (in frequency and volume).	Amortised cost*
Held both to collect contractual cash flows and for sale	• Both collecting contractual cash flows and sales are integral to achieving the objective of the business model. • Typically more sales (in frequency and volume) than held-to-collect business model.	FVOCI*
Others	• Objective: neither held-to-collect nor held to collect and for sale.	FVTPL**

* Subject to meeting the SPPI criterion and the fair value option.

** SPPI criterion is irrelevant – assets in all such business models are measured at FVTPL.

Assessment considerations

How are risks managed?

How is performance evaluated?

Any other factors?

How are managers compensated?

Actual and expected levels of sales?

Assessed at a level at which groups of assets are managed, e.g. a portfolio.

Classification of trade receivables

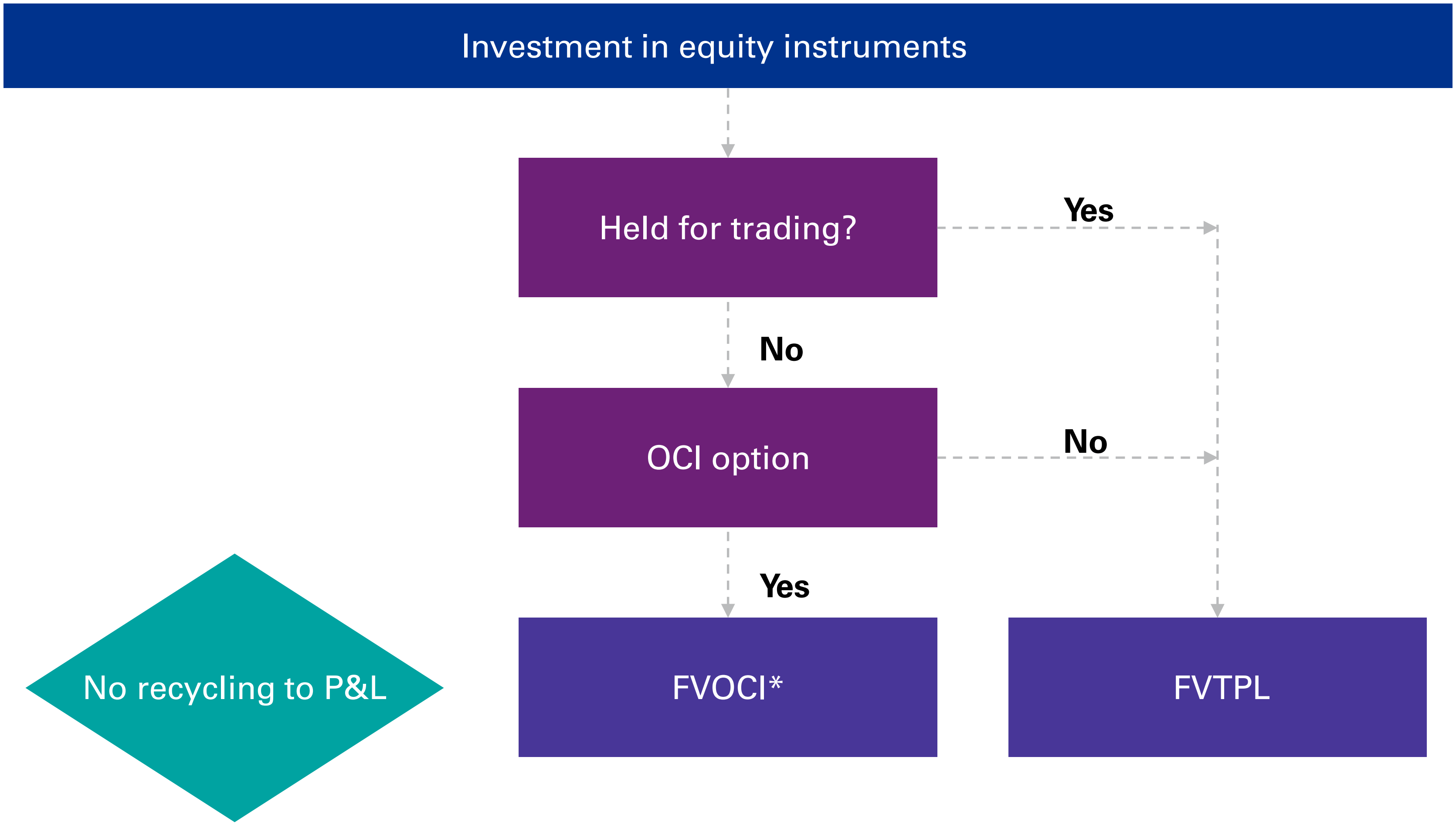
Classification criteria	Likely to meet?
SPPI	✔
Held-to-collect business model	✔

Trade receivables are likely to meet both criteria:

- Cash flows are generally fixed.
- Generally held to collect cash flows.

Watch out for the impact of securitisation and other transactions, including factoring, and for more complex contractual terms.

Classification of investments in equity instruments



* This election is irrevocable and can be made on an instrument-by-instrument (e.g. Individual share) basis.

Embedded derivatives

Is host contract a financial asset in the scope of Ind AS 109?

- **Yes** → Do not separate → Consider impact on SPPI criterion
- **No** → Follow the requirements on separation as given in Ind AS 109

Overview of Ind AS 109[1]

- Introduction
- Classification
- **Measurement**
- Key differences between Indian GAAP and Ind AS 109

Measurement at initial recognition

At initial recognition a financial instrument is measured at fair value

Transaction price is normally the best evidence of fair value on initial recognition

Exception: Trade receivables without significant financing component are recognised at transaction price defined by Ind AS 115.

Transaction costs included in initial measurement of financial instruments not classified as at FVTPL

Subsequent measurement: Financial assets

Ind AS 109	Criteria
Amortised cost	• Recognise interest revenue, expected credit losses and foreign exchange gains or losses in the statement of profit and loss • On derecognition, recognise any gain or loss in the statement of profit and loss.
FVOCI debt investments	• Recognise interest revenue, expected credit losses and foreign exchange gains or losses in the statement of profit and loss • Other gains or losses on remeasurement to fair value would be recognised in OCI • On derecognition, cumulative gain or loss previously recognised in OCI would be reclassified from equity to the statement of profit and loss.
FVOCI equity instruments	• Dividends generally recognised in profit or loss. • Other gains and losses recognised in OCI and never reclassified to profit or loss. • Impairment never recognised in profit or loss. • Cost measurement no longer permitted.
FVTPL	• Recognise all gains and losses in the statement of profit and loss.

Amortised cost: Effective interest method

Effective interest method calculates amortised cost and allocates interest income or expense over relevant period

Effective interest rate exactly discounts estimated future cash flows, without taking account of future credit losses, to the net carrying amount

Effective interest rate is calculated on initial recognition

Difference between effective interest for a given period and the instrument's coupon and any other cash received is the amortisation

Subsequent measurement: Financial liabilities

- Financial liabilities would be subsequently measured at:
  - Amortised cost
  - FVTPL
- Portion of the gain or loss on a financial liability designated as at FVTPL that is attributable to changes in its credit risk would be presented in OCI, with the remaining amount of the change in fair value presented in the statement of profit or loss.

Overview of Ind AS 109[1]

- Introduction
- Classification
- Measurement
- **Key differences between Indian GAAP and Ind AS 109**

Key differences between Indian GAAP and Ind AS 109

Scope	
• Current principles of financial instruments such as investments, forward exchange contracts, equity stock futures and options, securitisation transactions, guarantees and counter guarantees are spread across many different standards and guidance notes. While AS 30, *Financial Instruments: Recognition and Measurement* and AS 31, *Financial Instruments: Presentation* broadly cover these aspects, they are not currently mandatory. Further, there are separate regulations for loan loss provisions for banks/NBFCs and investment classification and valuation for banks, NBFCs, insurance companies, etc.	• Ind AS has broad mandatory accounting guidance for financial instruments. Under Ind AS, a financial instrument is any contract that gives rise to a financial asset of one company and a financial liability or equity instrument of another company. This definition also brings under its purview all kinds of derivative contracts, including embedded derivatives.
• Currently, contracts to purchase or sell a non-financial item (e.g. commodities or raw material) are generally viewed as executory contracts which do not have any accounting impact till the purchase or sale occurs.	• In certain cases, a contract to buy or sell a non-financial item could fall within the scope of a derivative under Ind AS, even though the non-financial item in itself is outside the scope of the financial instruments standard. For eg; contracts to buy or sell which can be 'net' settled or if the underlying non- financial item is readily convertible to cash are included in Ind AS 109.

Key differences between Indian GAAP and Ind AS 109

Recognition

- Currently, financial assets and liabilities are initially recognised at cost, including transaction costs.

- Under Ind AS, all financial instruments are recognised initially at their fair value plus directly attributable transaction costs (except those classified as fair value through profit or loss, where transaction costs are expensed as incurred). The initial difference that arises from the fair valuation of such financial assets and liabilities is accounted for to reflect the substance of the underlying transaction.

Categorisation and subsequent measurement

- Currently, investments are classified into:
  - Current investments: Measured at lower of cost and fair value
  - Long-term investments: Measured at cost less diminution, other than temporary.

- Under Ind AS, financial assets are classified as measured at:
  - Fair value through profit or loss
  - Fair value through other comprehensive income
  - Amortised cost

  Financial liabilities are classified as measured at:
  - Fair value through profit or loss
  - Amortised cost.

Key differences between Indian GAAP and Ind AS 109

Categorisation and subsequent measurement

- Equity instruments are measured at historical cost, and in certain cases such as current investments, at lower of cost or market value.

- Under Ind AS 109, equity investments will have to be measured at fair value with value changes recognized in profit or loss, except for those equity investments for which the entity has irrevocably elected (at initial consideration) to present in other comprehensive income (OCI) subsequent changes in the fair value of an investment in an equity instrument that is not held for trading.

Measurement of costs

- Currently, fees and costs incurred to originate loans are generally recognised as expenses when incurred. Similarly loan processing fees and other upfront fees charged to borrowers on loans are generally recognised upfront as revenue by the lender.
- Premium paid/payable on redemption of certain securities such as debenture, can be charged to securities premium.

- Under Ind AS, such costs, revenue, interest income/expense are required to be amortised over the relevant period of the loan, using the effective interest rate method.
- These are required to be considered in the computation of effective interest rate and recognised as expense in the statement of profit and loss over the term of the instruments).

Key differences between Indian GAAP and Ind AS 109

Embedded derivatives

- Currently, embedded derivatives are not required to be separately recognised.

- Under Ind AS 109, if a hybrid contract contains a host that is an asset within the scope of this standard, an entity should apply the requirements given in Ind AS 109 (relating to classification which includes SPPI criteria) to the entire hybrid contract.

- If a hybrid contract contains a host that is not an asset within the scope of this standard, an embedded derivative should be separated from the host and accounted for as a derivative under this standard.

- If an embedded derivative is separated, the host contract should be accounted for in accordance with the appropriate standards.

Draft interpretations on IAS 12[2] and IAS 21[3]

Draft IFRIC interpretation: Uncertainty over income tax treatment

- **What is the issue:** Draft IFRIC aims to reduce diversity in practice and clarifies accounting for income tax treatments that have yet to be accepted by income tax authorities, while also aiming to enhance transparency.

- **Timelines**

21 October 2015	**19 January 2016**	**Effective date**
IFRIC proposal issued	Comment deadline	To be determined

- **The proposals**
  – *When to provide for uncertainty:* Is it probable that the tax authority could accept the entity's chosen tax treatment?
    a) In case it is probable: Amount in the financial statements would be the same as in tax return.
    b) In case it is not probable: Amount in the financial statements would not be the same as in tax return.

Draft IFRIC interpretation: Uncertainty over income tax treatment (continued)

— *How to measure uncertainty:* If it is not probable that the tax authority would accept the treatment, reflect that uncertainty using (whichever provides a better prediction):

a) The most likely amount, or
b) The expected value.

— *Specific guidance on subsequent change in circumstances:* If circumstances change, an entity may need to update the amount in the financial statements. Specific guidance should be applied based on:

a) The time limit for tax inspections
b) New evidence, for example, tax inspection of the entity itself, publicly available information about tax treatment of other companies, court cases and clarifications.

- **The impacts**

— *Accounting:* Depending on current accounting and jurisdiction:

a) Current practice may change: There could be increase in the tax liability or recognise an asset. The proposals may also affect the timing of the respective item's derecognition.
b) Tax inspections may not give visibility: It may be more complex to estimate the amount of income tax if various taxes are assessed together.

— *Disclosures:* While no new disclosures have been proposed, users may expect more meaningful disclosures.

Draft IFRIC interpretation: Uncertainty over income tax treatment (continued)

- **Transition options:** The draft interpretation includes following two transition options:

  a) Retrospective application under IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors:* Equity would be adjusted at the beginning of the earliest prior period presented.

  b) Adjusting equity on initial application without adjusting comparative information: Equity would be adjusted at the beginning of the year of initial application.

Draft IFRIC interpretation: Foreign currency transactions and advance considerations

- **What is the issue:** IAS 21, *The Effects of Changes in Foreign Exchange Rates* sets out requirements about which exchange rate to use when recording a foreign currency transaction on initial recognition in the entity's functional currency. Diversity in practice was observed by the IASB in circumstances in which consideration was received or paid in advance of the recognition of the related asset, expense or income.

- **Determination of date of transaction:** The date of the transaction, for the purpose of determining the spot exchange rate used to translate the related asset, expense or income (or part of it) on initial recognition should be earlier of the following dates:
  a. the date of initial recognition of the non-monetary prepayment asset or the non-monetary deferred income liability, or
  b. the date that the asset, expense or income (or part of it) is recognised in the financial statements.

In case a transaction is recognised initially in stages, then a date of transaction is established for each stage.

Draft IFRIC interpretation: Foreign currency transactions and advance considerations (continued)

- **Transition options: On initial application, companies would apply the propose interpretation either:**

  a) Retrospectively in accordance with IAS 8, or

  b) Prospectively to all foreign currency assets, expenses and income in the scope of the proposed interpretation initially recognised on or after:

  - the beginning of the reporting period in which an entity first applies the proposed Interpretation, or

  - he beginning of a prior reporting period presented as comparative information in the financial statements of the reporting period in which an entity first applies the proposed interpretation.

Links to previous recordings of VOR

Month	Topics	Link
April 2014	• Companies Act, 2013 – implementation questions • SEBI corporate governance norms • New IFRS standard expected – Revenue from contracts with customers	Click here
May 2014	• Companies Act, 2013 - matters for first board and general meetings • Treatment of mark to market losses on principal only currency swaps – EAC opinion • Deferred tax liability on special reserve created by banks – impact on auditor's report • ICAI's road map for adoption of Ind AS	Click here
June 2014	• Revenue from contracts with customers - overview • Companies Act, 2013 – clarifications issued by the Ministry of Corporate Affairs (MCA)	Click here
July 2014	• IFRS convergence – key developments and challenges • Tax accounting standards – implementation challenges • Next steps for companies	Click here
August 2014	• Financial Instruments (2014) – an overview • 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	• Roadmap for IFRS convergence in India • Exposure draft on Ind AS 101, *First-time Adoption of Indian Accounting Standards* • Probable benefits and challenges of Ind AS conversion	Click here

Links to previous recordings of VOR

Month	Topics	Link
January 2015	• Ind AS implementation road map • Revised drafts on Income Computation and Disclosure Standards (ICDS) • Exposure Draft (ED) on Guidance Note (GN) on Accounting for Derivative Contracts	Click here
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
May 2015	• Salient features of Ind AS 16, *Property, Plant and Equipment* and Ind AS 38, *Intangible Assets* • Key differences between AS 10, AS 26, Ind AS 16 and Ind AS 38 • Key aspects of the application guide issued by the Institute of Chartered Accountants of India (ICAI)	Click here

Links to previous recordings of VOR

Month	Topics	Link
June 2015	• Overview of Ind AS 103, *Business Combinations* • Key differences between AS 14 and Ind AS 103 • Overview of key amendments introduced by the Companies (Amendment) Act, 2015	Click here
July 2015	• Overview of Ind AS 110, *Consolidated Financial Statements* and Ind AS 27, *Separate Financial Statements* • Key differences between AS 21, *Consolidated Financial Statements* and Ind AS 110 • Overview of key relaxations for private companies from certain provisions of the Companies Act, 2013	Click here
August 2015	• Overview of Ind AS 28, *Investment in Associates and Joint Ventures*, Ind AS 111, *Joint Arrangements* and Ind AS 112, *Disclosure of Interests in Other Entities* • Key differences between AS 23, *Accounting for Investment in Associates in Consolidated Financial Statements* and Ind AS 28 and between AS 27, *Financial Reporting of Interests in Joint Ventures* and Ind AS 111 • Overview of key clarifications to IFRS 15, *Revenue from Contracts with Customers* proposed by the IASB	Click here

Links to previous recordings of VOR

Month	Topics	Link
September 2015	• Updates related to accounting matters • Updates related to financial reporting matters • Other regulatory updates	Click here
October 2015	• Overview of Ind AS 32, *Financial Instruments, Presentation* • Key differences between Indian GAAP and and Ind AS 32 • Overview of exposure drafts on Ind AS 11, *Construction Contracts* and Ind AS 18, *Revenue*	Click here

Q&A

KPMG in India's IFRS institute

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 of registering as a member by providing certain minimal information.

To download KPMG content, become registered members of the website by following a 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) 109, *Financial Instruments* notified by the Ministry of Corporate Affairs (MCA) on 16 February 2015.
2. Draft IFRIC Interpretation DI/2015/1: Uncertainty over Income Tax Treatments published by the IFRS Interpretations Committee of the International Accounting Standards Board (IASB) on 21 October 2015.
3. Draft IFRIC Interpretation DI/2015/2: Foreign Currency Transactions and Advance Consideration published by the IFRS Interpretations Committee of the IASB on 21 October 2015.
4. Slide share presentation on 'Uncertainty over income tax treatments: Draft IFRIC aims to reduce diversity' available on https://home.kpmg.com/xx/en/home/insights/2015/10/income-tax-treatments-uncertainty-ifric-draft-ifrs-interpretations-committee-slideshare.html
5. KPMG's Insights into IFRS, 11th edition 2014-15.
6. Accounting Standard (AS) 31, *Financial Instruments: Presentation* issued by the Institute of Chartered Accountants of India (ICAI).
7. KPMG's publication: Transition to Ind AS - Practical Insights, May 2011.
8. KPMG's IFRS Notes: IFRS Convergence – ICAI issues exposure drafts on financial instruments and revenue recognition dated 29 October 2014.

Introducing IFRS Notes

Issue 2015/09

KPMG

IFRS NOTES
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The IASB agrees on an effective date for the new Leases Standard

27 October 2015

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Background

The International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) have been working towards a converged standard for accounting for leases that would bring most leases on-balance sheet. This joint project was intended to replace the current lease accounting requirements under IFRS and U.S. GAAP. Accordingly, the IASB and the FASB issued a revised Exposure Draft (ED) on leases in May 2013 which proposed changes towards both lessee and lessor accounting. The boards received extensive feedback on their proposals, and have heard a broad range of views. Since March 2014, they have redeliberated on almost all aspects of the project.

In their March 2015 meeting, the IASB and the FASB decided to prepare non-converged ballot drafts of their new standards on lease accounting i.e. to proceed with different lease accounting models.

New developments

The IASB expects to issue the new Leases Standard (IFRS 16) in December 2015.

The IASB agrees on an effective date for the new Leases Standard

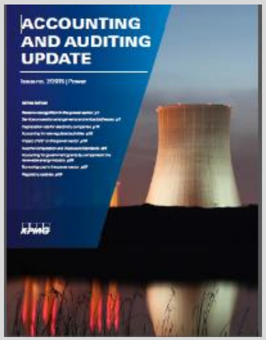
27 October 2015

The International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) have been working towards a converged standard for accounting for leases that would bring most leases on-balance sheet. This joint project was intended to replace the current lease accounting requirements under IFRS and U.S. GAAP. Accordingly, the IASB and the FASB issued a revised Exposure Draft (ED) on leases in May 2013 which proposed changes towards both lessee and lessor accounting. The boards received extensive feedback on their proposals, and have heard a broad range of views. In their March 2015 meeting, the IASB and the FASB decided to prepare non-converged ballot drafts of their new standards on lease accounting i.e. to proceed with different lease accounting models.

In its final meeting in October 2015, the IASB agreed on the effective date of the proposed standard. IFRS 16, would be effective for accounting periods beginning on or after 1 January 2019. An early adoption would be permitted, provided the company has adopted IFRS 15, *Revenue from Contracts with Customers.*

Topics discussed in AAU and First Notes

Accounting and Auditing Update (AAU)



Issue no. 2/2015 | Power

- Revenue recognition in the power sector
- Service concession arrangements and embedded leases
- Depreciation rate for electricity companies
- Accounting for rate regulated activities
- Impact of GST on the power sector
- Income Computation and Disclosure Standards
- Accounting for government grants by companies in the renewable energy industry
- Borrowing cost in the power sector
- Regulatory updates

First Notes

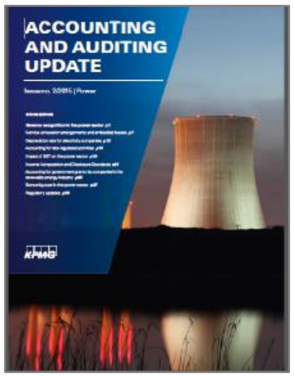
ICAI releases revised guidance on Internal Financial Controls Over Financial Reporting

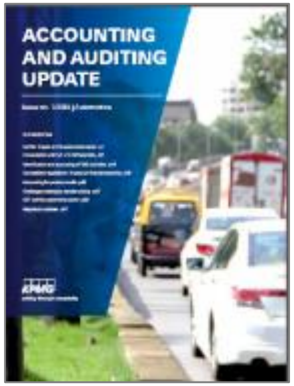
16 September 2015

Under Section 143(3)(i) of the Companies Act, 2013 (2013 Act), an auditor is required to state in their audit report whether the company has an adequate Internal Financial Controls (IFC) system in place and the operating effectiveness of such controls. Explanation to Section 134(5)(e) of the 2013 Act defines IFC to include policies and procedures adopted by the company for ensuring orderly and efficient conduct of its business, accuracy and completeness of the accounting records, and timely preparation of reliable financial information. The ICAI issued a Guidance Note in November 2014. This guidance note was revised subsequently and the ICAI issued a revised 'Guidance Note on Audit of Internal Financial Controls Over Financial Reporting' (Guidance Note) on 14 September 2015. Our issue of First Notes provides an overview of the Guidance Note issued by the ICAI.

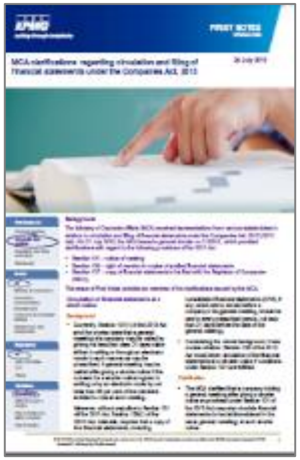
Others

Missed an issue of Accounting and Auditing Update?





Missed an issue of First Notes?



Coming up next

November 2015

New issue of:

- Accounting and Auditing Update
- First Notes
- IFRS Notes

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