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Editorial

We are pleased to introduce to you our quarterly newsletter covering the latest developments in financial reporting. You will find here articles spanning Indian GAAP, US GAAP, IFRS and relevant local and global regulatory updates. We have also provided a report card on the implementation of Ind-AS, India's converged accounting standards with IFRS.

This edition attempts to keep you informed of the key provisions and practical implications of the long-awaited new revenue recognition standard issued by the IASB and FASB as part of their convergence goal (the ICAI has also recently issued its exposure draft of Ind AS 115 based on this new IFRS revenue standard). This new standard under IFRS and US GAAP is expected to have a significant impact especially in the areas of variable consideration, contracts costs, multiple performance obligations and required incremental disclosures. It is also interesting to note that the commonly understood historical model of 'transfer of risk and rewards of ownership' has been replaced by 'transfer of control of good or service'. Management will need to closely evaluate the changes that might be necessary to IT systems, processes and internal controls in order to capture new data and address changes in financial reporting.

In recent times, service concession agreements have significantly increased for government and other regulatory bodies to undertake infrastructure projects as a part of the public private partnership initiative. In the absence of specific guidance under Indian GAAP, diverse accounting practices with respect to certain elements of service concession arrangements are noted. We have attempted to summarise some such practices, as well as provide a high-level summary of differences between Indian GAAP, IFRS and US GAAP on this topic.

We have also discussed current initiatives of the PCAOB, which includes its new auditing standard No 18 on related party transactions, significant unusual transactions and financial relationships and transactions with executive officers - which is quite topical today. Finally, some practical issues in relation to reporting of frauds under the new Companies Act 2013, recent amendments to Clause 49 of the Equity Listing Agreement by SEBI and a summary of the guidance on transfer pricing documentation and country-by-country reporting as finalized by OECD have also been articulated here.

We hope you find this newsletter informative and helps us remain connected with you in a meaningful manner.

We look forward to your feedback at pwc.updates@in.pwc.com

Adoption of Indian Accounting Standards ('Ind-AS')

In his recent Budget speech, the Finance Minister has proposed the adoption of Ind-AS, India's converged accounting standards with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board. The Minister indicated that Ind-AS to be adopted mandatorily, beginning FY 2016–17 and voluntarily from FY 2015–16. The Minister also mentioned that for banks and insurance companies, the respective regulators will separately notify the date of Ind-AS implementation. This step will not only pave the way for Ind-AS adoption in India but more importantly, reinforce to the global community India's resolve towards strong corporate governance practices.

Separately in March 2014, the Institute of Chartered Accountants of India (ICAI) has also submitted a revised roadmap for the implementation of Ind-AS to the Ministry of Corporate Affairs (MCA). In its latest roadmap for achieving convergence, the ICAI has suggested that two separate sets of accounting standards be notified under the Companies Act. The first set will comprise the IFRS converged Ind-AS to be used for the preparation of consolidated financial statements (CFS) for a specified class of companies. The second set will comprise the existing notified Accounting Standards (AS) to be used for the preparation of individual financial statements of companies preparing CFSs per Ind-AS and for the financial statements of other companies. In this regard, the ICAI has suggested that Ind-AS be applied to the following specified class of companies for preparing their first Ind-AS CFS beginning accounting period on or after 1 April, 2016, with comparatives for the year ending 31 March, 2016 or thereafter:

a. Companies whose equity and/or debt securities are listed or are in the process of listing on any stock exchange in India or outside India;

b. Companies other than those covered in (a) above, having a net worth of 500 crore INR or more;

c. Holding, subsidiary, joint venture or associate companies of companies covered under (a) or (b) above.

These developments denote progress, because basis the above class of companies Ind-AS will impact a fairly large proportion of corporate India. However, there are still certain signposts to cross so that this time, adoption of Ind-AS can be smooth and incorporates lessons from previous learnings. In this context, some key matters for consideration are set out below:

- So far, thirty five Ind-AS have been placed on the website of the MCA. However, since 2011, there have been revisions to existing IFRS including the issuance of new IFRS. Keeping pace with these developments, the ICAI has also since then issued eleven exposure drafts (EDs) of standards and other amendments. Some of these EDs relate to major global IFRS convergence projects, which will have a significant impact on financial statements for example standards on consolidation, joint arrangements, fair value, and the most recent ones on revenue recognition and financial instruments. Both preparers and auditors are already dealing with various changes resulting from the Companies Act 2013 (the 2013 Act), and will therefore require adequate time and resources to prepare for implementation of Ind-AS. Accordingly, the revision to Ind-AS and the finalisation of EDs /new Ind-AS to bring them in line with IFRS should be completed and notified on priority – of course after due deliberation between all constituents i.e. the industry, the profession and regulators.

It is important to note that some of the new IFRS e.g. IFRS 15 – Revenue from Contracts with Customers and IFRS 9 – Financial Instruments for which corresponding Ind-AS EDs have been issued as recent as 30 September have far-reaching implications spanning industries. Globally these new IFRS have effective dates of 1 January, 2017 and 2018, respectively. Accordingly, their implementation in context of the ICAI's road map needs to be carefully evaluated – because based on this road map, India could be adopting the corresponding Ind-ASs before the rest of the world. Companies will need to plan ahead for significant changes that will be required based on these new IFRS standards.

- The applicability of accounting standards to separate or individual financial statements is another important area. The ICAI's roadmap recommends that Ind-AS will be applicable for CFS and the existing notified AS will be applicable for the preparation of individual or separate financial statements. Further, the Finance Minister in his Budget speech has suggested that for the purpose of tax computation, separate tax accounting standards will be notified. We believe more thought and broader deliberation is required on this subject, as it can be quite cumbersome for companies if they have to prepare their CFS and separate financial statements using multiple frameworks such as Ind-AS, tax accounting standards or existing notified AS.

  This also impacts many areas such as distribution of dividends, managerial remuneration, income taxes, etc. presently based on separate or individual financial statements. We need to think through practical and long lasting solutions.

- The Finance Minister in his speech also mentioned that the adoption of Ind-AS by banks, insurance entities, etc. will be considered separately. This again needs to be evaluated carefully, especially ways in which it will impact the preparation of CFS by a parent company which may have one or more of such entities as an associate, subsidiary or joint venture. This could also potentially result in such entities adopting Ind-AS for the purpose of consolidation at a date different than for its own separate or individual financial statements, which may not necessarily be a desired consequence.

- The ICAI has recently issued an Ind-AS ED proposing an exemption for an intermediate holding company from the preparation of CFS subject to the fulfilment of certain conditions similar to IFRS. This is a welcome proposal, absent which, the specified classes of companies per ICAI's roadmap would have to prepare multiple sets of consolidated financial statements within a group, causing heavy burden and cost for the preparers of such financial statements. However, currently there are no such exemptions in the new 2013 Act for intermediate holding companies from preparing CFS requiring a need for harmonisation between the 2013 Act and Ind AS.

- The benefit from such a requirement needs to be weighed in context of the heavy burden and cost this may create for the preparers of financial statements.

- Presently, there are certain differences between Ind-AS and IFRS 'carve outs'. Some hold a view that new or existing Ind-AS should be finalised or amended with no or very limited carve-outs taking cognisance of factors specific to the Indian business and regulatory environment. This is so that a high level of comparability and convergence with IFRS can be achieved. Others hold a view that companies could also be provided an option to fully adopt provisions of IFRS i.e. without the carve-outs. The latter would also be in line with current SEBI guidelines, which permit companies to prepare their CFS under IFRS. This issue is quite important especially for certain Indian companies who are already preparing their CFS under IFRS. Would it now be reasonable for such companies to again prepare their CFS using Ind-AS when they have already been using IFRS?

What is next?

The industry, regulators and the profession need to enhance the level of engagement and dialogue including with the IASB (where relevant) on such matters which are specifically important in the context of our Indian business and regulatory environment, thereby trying to influence standard setting activities where relevant. Any feedback is more likely to be considered if such dialogue is undertaken during the early stages of the standard setting process. This may also help eliminate or minimise differences between Ind-AS and IFRS.

Additionally, one can see from the above that several open matters remain and there are more questions than answers in the context of corporate India's adoption of Ind-AS. We hope some of these matters get ironed out so that Ind-AS implementation is seamless. Until then, companies need to closely monitor these developments including the review of existing thirty five Ind-AS, eleven Ind-AS EDs and other amendments. If we were to refer to the Finance Minister's speech and ICAI's currently proposed roadmap, the opening balance sheet date of April 2015 is not too far.

Revenue recognition

Finally on 28 May, the IASB and FASB issued their long-awaited converged standard on revenue recognition. On September 30, the ICAI has also issued its ED of the Ind AS 115, Revenue from Contracts with Customers, which is similar to IFRS 15 discussed below.

The objective of the revenue standard (ASC 606 and IFRS 15) is to provide a single, comprehensive revenue recognition model for all contracts with customers to improve comparability within and across industries as well as across capital markets. Almost all entities will be affected to some extent either by the significant increase in required disclosures or changes that might be necessary to IT systems, processes and internal controls in order to capture new data and address changes in financial reporting. The magnitude of impact will depend on industry and current accounting practices followed by entities under IFRS and US GAAP.

The revenue standard contains principles that an entity will apply to determine the measurement of revenue and timing of when it is recognised. The underlying principle is that an entity will recognise revenue to depict the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. This is a significant change as "Transfer of control is not the same as transfer of risks and rewards, nor is it necessarily the same as the culmination of an earnings process as it is considered today".

The standard has a five-step revenue recognition model:

Step 1: Identify the contract(s) with the customer.

Step 2: Identify the separate performance obligations in the contract.

Step 3: Determine the transaction price.

Step 4: Allocate the transaction price to separate performance obligations.

Step 5: Recognise revenue when (or as) each performance obligation is satisfied.

We will discuss the key principles of this five-step model and some practical implementation matters to consider:

Step 1: Identify the contract(s) with the customer

The revenue standard applies to all contracts with customers. Accordingly, revenue from a transaction or event not arising from a contract with a customer would not be within the scope of this standard. Such transactions or events include, but are not limited to dividends; non-exchange transactions; changes in regulatory assets and liabilities for rate-regulated activities. Further, a customer is a party that contracts with an entity to obtain goods or services that are the output of that entity's ordinary activities.

A contract is an agreement between parties that creates enforceable rights and obligations. It can be written, oral or implied by an entity's customary business practice. Generally, any agreement that creates enforceable rights and obligations will meet the definition of a contract. An entity will apply the revenue standard to each contract with a customer when all of the following criteria are met:

- The parties have approved the contract and intend to perform their respective obligations.
- Each party's rights regarding the goods or services to be transferred can be identified.
- The payment terms can be identified.
- The risk, timing, or amount of the entity's future cash flows are expected to change (that is, the contract has commercial substance).
- It is probable that the entity will collect the consideration to which it will be entitled in exchange for goods or services transferred.

If a contract with a customer does not meet the criteria at inception, an entity will continue to assess the contract at each reporting period to determine whether the criteria are subsequently met. An entity that receives consideration from the customer when the criteria are not met will not recognise revenue until either:

- The entity has no remaining performance obligations and substantially all the consideration is received and nonrefundable, or

An entity will now be required to assess at the inception of the contract whether the transaction price is probable of collection. This assessment is important as it will not determine whether a contract exists for the purpose of applying the revenue standard.

Also, it is important to note that assessment of collectability is based on the customer's ability and intent to pay as amounts become due. Credit risk is to be considered but not other uncertainties such as those related to performance or measurement, which are to be considered separately during revenue recognition. Credit losses arising from a contract that was probable of collection at inception will continue to be recognised as an expense in the income statement.

The contract is terminated and amounts received are nonrefundable. The standard also includes specific guidance for contract combination and modification.

A contract modification occurs when the parties approve a change that either creates new or changes existing enforceable rights and obligations. Approval can be in writing, oral, or implied by customary business practice. Management will need to determine when a modification, such as a claim or unpriced change order, is approved and therefore creates enforceable rights and obligations. An entity will not account for a modification until it is approved; that is, it will continue to apply the revenue standard to the existing contract.

An entity will account for a modification prospectively if the goods or services in it are distinct from those transferred before the modification. The remaining consideration in the original contract not yet recognised as revenue is combined with the additional consideration promised in the modification to create a new transaction price that is then allocated to all remaining performance obligations (that is, those not yet completed in the original contract and those added through the modification). This effectively accounts for the modification as a termination of the original contract and the inception of a new contract for all performance obligations that remain unperformed.

Accounting guidance for contract modifications did not previously exist for most industries and arrangements. The new guidance therefore provides structure in an area where practice was previously mixed. Management will need to apply judgement when evaluating whether goods or services in a modification are distinct, and whether the price reflects the standalone selling price to determine the accounting. This might be more challenging in situations where there are multiple performance obligations in a contract, or when modifications occur frequently. This in turn impacts whether the entity should account for the modification on a prospective basis or cumulative catch-up basis.

An entity will account for a modification through a cumulative catch-up adjustment if the goods or services in the modification are not distinct from those in the original contract and are thus part of a single performance obligation that is only partially satisfied. The measure of progress towards satisfying the performance obligation is updated to reflect performance completed and performance that remains.

The revenue standard provides indicators rather than criteria to determine when a good or service is distinct within the context of the contract. This allows managementto apply judgement to determine separate performance obligations that best reflect the economic substance of a transaction. All promises in an arrangement should be identified. Promises that are inconsequential or perfunctory need to be identified, even if they are not the 'main' deliverable in the arrangement, because all promises in a contract are goods or services that a customer expects to receive. An entity needs to assess whether inconsequential or perfunctory performance obligations are immaterial to the financial statements.

Step 2: Identify the separate performance obligations in the contract

A performance obligation is a promise to transfer a distinct good or service to a customer. The promise can be explicit, implicit or implied by an entity's customary business practice. The objective of identifying distinct performance obligations is to depict the transfer of goods or services to the customer. Identifying performance obligations can be challenging when there are multiple explicit or implicit promises in a contract.

Management will need to determine whether promises are distinct when there are multiple promises in a contract. This is important because distinct performance obligations are the units of account that determine when and how revenue is recognised. A good or service is distinct only in the following cases:

- the customer can benefit from the good or service either on its own or together with other readily available resources (that is, the goods or services are capable of being distinct); and
- the good or service is separately identifiable from other promises in the contract (that is, the good or service is distinct within the context of the contract).

A customer can benefit from a good or service on its own if it can be used, consumed or sold to generate economic benefits. A good or service that cannot be used on its own, but can be used with readily available resources, is still distinct, as the entity has the ability to benefit from it. A readily available resource is one that is sold by the entity, by others in the market, or that a customer has already obtained from the entity.

Determining whether a good or service is distinct within the context of the contract requires assessment of the contract terms and the intent of the parties. Indicators include, but are not limited to the following:

- The entity does not provide a significant service of integrating individual goods or services in the contract into a bundle that is the combined item the customer has contracted to receive.
- The good or service does not customise or significantly modify another contractually promised good or service.
- The good or service is not highly dependent on or highly inter-related with other goods or services in the contract. Therefore, a customer's decision to not purchase a good or service does not significantly affect the other promised goods or services in the contract.

Goods or services that are not distinct need to be combined with other goods or services until the entity identifies a bundle of goods or services that is distinct.

Step 3: Determine the transaction price

The transaction price is the amount of consideration an entity expects to be entitled to in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of a third party (for example, some sales taxes). Determining the transaction price is more complex if the arrangement involves variable consideration, a significant financing component, non-cash consideration, or consideration payable to a customer.

Variable consideration and the constraint on revenue recognition

The transaction price might include an element of consideration that is variable or contingent on the outcome of future events, including (but not limited to) discounts, refunds, rebates, credits, incentives, performance bonuses and royalties. Consideration can also vary if an entity's ability to retain a fixed amount of consideration is contingent upon a future event. An entity's practices, policies or statements might also result in variable consideration. For example, if they indicate the entity will provide price concessions.

Variable consideration should be estimated using the more predicative of the following approaches: the expected value or the most likely amount. The expected value approach represents the sum of probability-weighted amounts for various possible outcomes. The most likely amount represents the most likely amount in a range of possible amounts. The approach used is not a policy choice. Management needs to use the approach that it expects will best predict the amount of consideration to which the entity will be entitled based on the terms of the contract and taking into account all reasonably available information. The approach used needs to be applied consistently throughout the contract.

Variable consideration included in the transaction price is subject to a constraint. An entity should recognise revenue as performance obligations are satisfied only if it is probable (US GAAP) or highly probable (IFRS) that a change in the estimate of the variable consideration will not result in a significant reversal of the cumulative revenue recognised. This assessment will often require judgement. The following indicators suggest that including an estimate of variable consideration in the transaction price could result in a significant reversal of cumulative revenue:

- The amount of consideration is highly susceptible to factors outside the entity's influence.
- Resolution of the uncertainty about the amount of consideration is not expected for a long period of time.
- The entity has limited experience with similar types of contracts.
- The entity has a practice of offering a broad range of price concessions or changing payment terms and conditions in similar circumstances for similar contracts.
- There is a large number and broad range of possible outcomes.

Management will need to determine if there is a portion of the variable consideration (that is, some minimum amount) that should be included in the transaction price, even if the entire estimate of variable consideration is not included due to the constraint. Management's estimate of the transaction price will be re-assessed each reporting period, including any estimated minimum amount of variable consideration.

This is a significant change from current practice. The scope of the variable consideration guidance introduced in this standard is broad and includes amounts that historically might not have been viewed as variable consideration. For example, fixed amounts that an entity is entitled to only upon the achievement of certain events are variable consideration under the revenue standard and included in the transaction price subject to the constraint. Management will need to think broadly about amounts, whether fixed or variable, that will be accounted for as variable consideration. The evaluation of variable consideration will require judgement in many cases.

Entities that deferred revenue recognition under current guidance because the price is not fixed or determinable (US GAAP) or reliably measurable (IFRS) could be significantly affected by the new standard. An example is a situation where the price is fixed, but the entity has a history of granting concessions. Entities could be required to recognise some minimum amount of revenue when control transfers as opposed to waiting until the extent of price concessions is resolved. This is because it is unlikely that an entity will be willing to grant a concession for 100% of the price.

New processes might be needed for making and monitoring estimates of variable consideration on an ongoing basis. Concurrent documentation of the judgements considered in making estimates will also be important.

The constraint also applies to contracts with a fixed price if it is uncertain whether the entity will be entitled to all of the consideration even after the performance obligation is satisfied. One example is an entity that enters into a contract with a customer to provide tax services in return for a fixed fee, but the entity will only be paid if the tax court rules in favour of the customer. The entity might not be able to recognise revenue until the court rules on the case, even though tax services have been provided. However, if management considers it probable (US GAAP) or highly probable (IFRS) that the fee is not subject to significant reversal of cumulative revenue, the entity will recognise revenue prior to the court's ruling.

Performance-based incentive fees (for example, fees that vary based on the achievement of a contract milestone or an investment portfolio's performance) are also variable consideration and therefore subject to the constraint.

The standard includes a narrow exception to the constraint on variable consideration for sales- or usage-based royalties on licences of intellectual property (IP). Royalties from licences of IP are not included in the transaction price until they are no longer variable (that is, when the customer's subsequent sales or usage occur).

Management will need to apply judgement to determine whether an arrangement qualifies for the exception to the overall variable consideration constraint, given that neither 'intellectual property' nor 'royalty' are defined in US GAAP or IFRS. The boundaries for determining when the sales- and usage-based exception applies might be an area of the new standard that is subject to further clarification.

Significant financing component

The transaction price should be adjusted for any significant financing component in the arrangement. A practical expedient allows entities to disregard the time value of money if the period between transfer of the goods or services and payment is less than one year, even if the contract itself is for more than one year.

An entity that is paid in advance for goods or services need not reflect the effects of the time value of money when the timing of transfer of those goods or services is at the customer's discretion. For example, if a customer purchases a prepaid phone card from a telecom entity and uses the prepaid airtime at its discretion, the time value of money need not be considered. Another example is a customer loyalty programme where the customer can redeem the points awarded by the entity at its discretion. Those entities will not be required to account for time value of money even though there could be a significant timing difference between payment and performance.

The amount of revenue recognised will be different from the amount of cash received from the customer when an arrangement contains a significant financing component. Revenue recognised will be less than cash received when payments are made after performance, because the entity is providing the customer with financing. A portion of the consideration will be recognised as interest income. Revenue recognised will exceed the cash received for payments made in advance of performance, because the entity receives financing from the customer. The entity will recognise interest expense on the financing related to advanced payments.

Non-cash consideration

An entity will measure any non-cash consideration exchanged in the transaction (including equity of the customer) at its fair value to determine the transaction price. An entity will measure the consideration indirectly by reference to the standalone selling price of the goods or services promised in the arrangement if it cannot reasonably estimate the fair value of the non-cash consideration.

An entity could have a customer that contributes goods or services (for example, materials or labour) to facilitate the fulfillment of a contract. The entity will need to assess whether it obtains control of those contributed goods or services to determine whether they are non-cash consideration and therefore revenue to the entity.

The guidance related to a significant financing component is different than current guidance related to applying the time value of money. In some cases, identification of a significant financing component will be easy and challenging in other cases, though the standard does allow for some level of judgement.

For example, a software entity agrees to provide three years of post-contract customer support (PCS) for 600 USD, which the customer pays upfront and can renew for 200 USD annually after the initial three-year period. The entity will need to consider whether there is a significant financing component because the customer paid 600 USD in advance, but there is no discount for paying upfront as compared to the annual pricing (200 USD per year). If the advance payment is required for reasons other than obtaining financing, such as for business purposes to obtain a longer-term contract, then the entity will conclude that a significant financing obligation does not exist.

Entities may also need to consider any operational challenges relating to measuring and tracking the interest element of the arrangement, which could require additional IT systems, processes or internal controls to capture and measure such information.

Consideration payable to a customer

Consideration paid (or expected to be paid) to a customer or to a customer's customer reduces the transaction price unless the payment is made in exchange for a distinct good or service that the customer transfers to the entity. The definition of 'distinct' is consistent with the guidance in step 2 for identifying performance obligations.

Consideration paid or payable to a customer (or to other parties that purchase the entity's goods or services from the customer) includes cash, credits or other items that can be applied to amounts owed to the entity. For example, a coupon or voucher that an end customer can redeem to reduce the purchase price of the entity's goods sold through a distributor is consideration payable to a customer.

Consideration that is a payment for a distinct good or service is accounted for consistently with how an entity accounts for other purchases from suppliers. If the consideration paid for distinct goods or services is above the fair value of those goods or services, any excess is recorded as a reduction of the transaction price.

Step 4: Allocate the transaction price to separate performance obligations

The transaction price is allocated to the separate performance obligations in a contract based on the relative standalone selling prices of the goods or services promised. This allocation is made at contract inception and not adjusted to reflect subsequent changes in the standalone selling prices of those goods or services.

The best evidence of a standalone selling price is the observable price of a good or service when the entity sells that good or service separately. Management will need to estimate the selling price of goods or services that do not have an observable standalone selling price, and should maximise the use of observable inputs when making that estimate. Possible estimation methods include, but are not limited to the following:

- Expected cost plus an appropriate margin
- Assessment of market prices for similar goods or services adjusted for entity-specific costs and margins
- Residual approach, in limited circumstances

Under current guidance, entities generally allocate the consideration to individual components or deliverables in an arrangement. Under US GAAP, the amount of revenue allocated to the delivered component(s) is limited to the non-contingent amount. This revenue standard does not include a requirement to limit the amount of the transaction price allocated to a delivered component to the non-contingent amount.

Residual approach

A residual approach can only be used to calculate the standalone selling price of a distinct good or service, if the selling price is highly variable or uncertain. It can be applied regardless of whether that good or service is delivered at the beginning or at the end of the contract. A selling price is highly variable when an entity sells the same good or service to different customers (at or near the same time) for a broad range of amounts. A selling price is uncertain when an entity has not yet established a price for a good or service and it has not been sold previously.

The residual approach requires that an entity first determines if any discounts need to be allocated to specific performance obligations in accordance with the guidance discussed below, prior to using the residual approach to determine the standalone selling price of the remaining item(s). If the discount is not allocated to specific performance obligations, the management will allocate the discount proportionately to all performance obligations within the contract.

The residual approach under this standard is different from the residual method that is used by some entities today (for example, software companies). Application of the current residual method results in the entire discount in an arrangement being allocated to the first item delivered under the contract. This will not be the case under the new guidance because discounts will typically be allocated proportionately to all items.

Use of the residual approach needs to be limited, and it will be used less frequently than the residual method is used today. Currently, an entity that applies the residual method should not presume that it will be able to use a residual approach to estimate the selling price under the new standard, and should not expect the residual method and the residual approach to have identical results.

Allocating discounts and variable consideration

Discounts and variable consideration will typically be allocated proportionately to all of the performance obligations in the contract. If certain conditions are met, a discount or variable consideration can be allocated to one or more separate performance obligations, rather than to all performance obligations in the arrangement. An entity needs to allocate a discount entirely to one or more performance obligation(s), if all of the following criteria are met:

- The entity regularly sells each distinct good or service (or each bundle. of distinct goods or services) on a standalone basis.
- The entity regularly sells, on a standalone basis, a bundle of some of those goods or services at a discount to the standalone selling prices of the goods or services within that bundle.
- The discount attributable to the bundle of goods or services is substantially the same as the discount within the contract.

An arrangement will need to include at least three performance obligations in order to apply this guidance, since the entity will need to regularly sell at least two performance obligations together to evidence that a subset of the arrangement is separately sold at the discount. The revenue standard includes multiple examples to illustrate how an entity will allocate discounts and variable consideration.

Step 5: Recognise revenue when (or as) each performance obligation is satisfied

The final step in the model is recognising revenue. An entity will recognise revenue when (or as) a good or service is transferred to the customer, and the customer obtains control of that particular good or service. Control of an asset refers to an entity's ability to direct the use of, and obtain substantially all of the remaining benefits (that is, the potential cash inflows or savings in outflows) from the asset. Directing use of an asset refers to a customer's right to deploy that particular asset, to allow another entity to deploy that asset in its activities, or to restrict another entity from deploying that particular asset.

The standard requires the management to determine when the control of a good or service has been transferred to the customer. The timing of revenue recognition can change for some transactions as compared to the current guidance, which is more focussed on the transfer of risks and rewards. The transfer of risks and rewards is an indicator of whether control has been transferred, however, additional indicators will also need to be considered. For example, an entity that transfers control of a particular good to a customer, but retains some economic risks, might need to record revenue when the good is transfered, while under the existing guidance, revenue recognition might be delayed until all of the economic risks have also been transferred.

An entity needs to determine at contract inception whether control of a good or service is transferred over time or at a particular point in time. This determination should depict the transfer of benefits to the customer and needs to be evaluated from the customer's perspective. An entity needs to first assess whether the performance obligation is satisfied over time. If not, the good or service transfers at a point in time or in other words, performance obligation is satisfied at a point in time.

Performance obligations satisfied over time

An entity will recognise revenue over time if any of the following criteria are met:

- The customer concurrently receives and consumes the benefits provided by the entity's performance as the entity performs.
- The entity's performance creates or enhances a customer-controlled asset.
- The entity's performance does not create an asset with an alternative use and the entity has a right to payment for performance completed to date.

The first criterion generally addresses service contracts where no asset is created and the customer consumes the services as and when they are provided. The performance obligation is satisfied over time if another entity will not have to substantially reperform the work completed to date in order to fulfill the remaining obligation to the customer. For example, a contract with a customer to provide daily security services of an office building would meet this criterion.

The second criterion addresses transactions where an asset is created or enhanced, and the customer controls that particular asset as it is created. This is applicable in situations where the customer controls the work-in-progress as the entity manufactures goods. For example, it is common in transactions with a government, that the government entity (the customer) controls any work-in- progress or other output of the contract. The management needs to apply the guidance on transfer of control so as to determine whether the customer obtains control of the asset as it is created.

The last criterion addresses situations where the customer does not control an asset as it is created, or no asset is created by the entity's performance. The management will need to consider whether the asset being created has an alternative use to the entity (if an asset is created) and whether the entity has an enforceable right to payment for performance to date. The assessment of whether an asset has an alternative use needs to be made at contract inception, and not reassessed. The management needs to consider its ability to redirect a product that is partially completed to another customer, considering both contractual as well as practical limitations.

A substantive contractual restriction that limits the management's ability to redirect the asset can indicate that the asset has no alternative use. Practical limitations such as significant costs required to rework the asset so it could be directed to another customer, could also indicate that the asset has no alternative use.

A right to payment exists if an entity is entitled to payment for performance completed to date if the customer terminates the contract for reasons other than the entity's non-performance. The right to payment needs to compensate the entity at an amount that reflects the selling price of the goods or services provided to date, rather than provide compensation for only the costs incurred to date or the entity's potential loss of profit if the contract is terminated. This will be an amount that covers an entity's cost plus a reasonable profit margin for the work completed.

For a performance obligation satisfied over time, the objective is to recognise revenue in a manner that depicts the transfer of control of the promised goods or services to the customer. Methods for measuring progress include the following:

- Output methods such as units produced or delivered, contract milestones, or surveys of work performed
- Input methods such as costs incurred, labour hours expended, time lapsed, or machine hours used

Entities using an input method to measure progress need to exclude the effects of the inputs that do not depict the transfer of control to the customer, for example, uninstalled materials, costs attributable to significant inefficiencies within the entity's performance, etc. Also, revenue should only be recognised if the entity can reasonably measure its progress toward complete satisfaction, for which it must have reliable information that can be applied to an appropriate method of measuring progress to meet this objective. An entity that cannot reasonably measure the outcome of a performance obligation, but expects to recover the costs incurred, should recognise revenue only to the extent of the costs until a reliable measure of progress can be made.

The management will need to apply judgment to assess the criteria to determine the point in time at which a customer obtains control - for example, manufacturers of large volumes of homogeneous goods produced to a customer's specification might be surprised to find that they could meet the criteria for performance obligations satisfied over time. This is because (1) such goods often have no alternative use to the entity, given their customisation or contractual restrictions (2) the payment terms in these arrangements might include a protective clause that provides for payment for performance to date in the event the contract is cancelled.

Entities that manufacture these types of goods could be required to recognise revenue as the goods are produced, rather than when they are delivered to the customer.

Differences in payment terms can result in goods being treated as a performance obligation satisfied over time in one case and as inventory transferred at a point in time in another. The 'right to payment' criterion might not be satisfied if the customer only provides reimbursement for the cost of units in production.

Performance obligations satisfied at a point in time

An entity will recognise revenue at a point in time (when control transfers) for performance obligations that do not meet the criteria for recognition of revenue over time. In order to determine when a customer obtains control, and an entity satisfies a performance obligation, the entity needs to consider the definition of transfer of control and the following indicators:

- The entity has a present right to payment for the asset
- The entity transferred legal title to the asset
- The entity transferred physical possession of the asset
- The entity transferred the significant risk and rewards of ownership to the customer
- The customer accepted the asset

All of the indicators above do not need to be satisfied for revenue to be recognised at a point in time. The standard does not place more weight on one indicator over another. An entity will need to consider all indicators, not just whether significant risk and rewards have transferred, to determine when revenue should be recognised.

Other considerations

Several issues exist beyond applying the five steps of the model. The revenue standard provides guidance in the following areas to assist entities in applying the model.

Licenses

A license establishes a customer's rights related to an entity's Intellectual Property(IP) and the entity's obligations related to those rights. Licenses of IP include, among others: software and technology rights, media and entertainment rights, franchises, patents, trademarks and copyrights.

An entity should first consider the guidance for distinct performance obligations to determine if a license is distinct from other goods or services in an arrangement. It will combine licenses that are not distinct with other goods as well as services in the contract, and recognise revenue when it satisfies the combined performance obligation. Examples of licenses that are not distinct include a license that is integral to the functionality of a tangible good (such as software included on a hardware device) or a license that the customer can benefit from only in conjunction with a related service (such as access to online internet content). The nature of the rights provided in some license arrangements is to allow access to the entity's IP as it exists throughout the license period. Licenses that provide access are performance obligations satisfied over time and, therefore, revenue is recognised over time.

The nature of the rights in other transactions is to provide a right to use the entity's IP as it exists at the point when the license is granted. Licenses that provide a right to use an entity's IP are performance obligations satisfied at a point in time, with the revenue recognised when control transfers to the licensee and the license period begins.

Distinct licenses that meet all of the following three criteria provide access to IP (and thus, revenue is recognised over time):

- The licensor will undertake (either contractually or based on customary business practices) activities that significantly affect the IP to which the customer has rights.
- The licensor's activities do not otherwise transfer a good or service to the customer as they occur.
- The rights granted by the license directly expose the customer to any effects (both positive as well as negative) of those activities on the IP, and the customer entered into the contract with the intent of being exposed to those effects.

The revenue standard includes a number of examples that illustrate how an entity should apply the criteria to different license arrangements. Applying these criteria can be challenging and will require judgment, especially to determine what constitutes an activity rather than a separate performance obligation. Different accounting conclusions might be reached for arrangements that appear to be similar, which could make comparability across entities and industries more challenging.

Contract costs

An entity needs to recognise an asset for the incremental costs incurred to obtain a contract if the management expects to recover those costs. Incremental costs of obtaining a contract are costs the entity would not have incurred if the contract had not been obtained (for example, sales commissions). Costs that the entity would have incurred if the contract had not been obtained, such as facilities cost and sales force salaries are not capitalised.

An entity can elect to expense the cost of obtaining a contract if the amortisation period will be one year or less.

An entity will recognise an asset for costs to fulfill a contract if those costs:

- Relate directly to a contract or anticipated contract that the entity can specifically identify
- Generate or enhance the entity's resources that will be used to satisfy future performance obligations
- Are expected to be recovered

The management will need to consider whether the costs to fulfill a contract need to be accounted for in accordance with other standards (for example, inventory, fixed assets, or intangible assets) before applying the revenue standard. Costs that relate to satisfied performance obligations are expensed as incurred.

An asset recognised for the costs to obtain or fulfill a contract will be amortised on a systematic basis, as the goods or services to which the assets relate to are transferred to the customer. The asset will also be assessed for impairment each reporting period.

The guidance on contract costs is expected to result in the recognition of more assets than under current practice. Entities that expense sales commissions as paid and set-up costs as incurred could now be required to capitalize and amortize these costs if they are recoverable.

Repurchase agreements

An entity that has an obligation or right to repurchase an asset (a forward or a call option) has not transferred control of the asset to the customer because the customer is limited in its ability to direct the use of and obtain substantially all of the remaining benefit from the asset. An entity will account for the contract as a lease, if it can or must repurchase the asset for a price that is less than the original selling price, unless the contract is part of a sale-leaseback transaction. It will account for a contract as a financing if it can or must repurchase the asset for a price that is equal to or greater than the original selling price of the asset. While comparing the repurchase price to the selling price, an entity needs to consider the time value of money.

An arrangement wherein a customer has the right to require the entity to repurchase an asset (a put option) at a repurchase price less than the original selling price will be accounted for as a lease, if the arrangement provides the customer with a significant economic incentive to exercise that right, unless the contract is part of a sale-leaseback transaction. The arrangement is a financing transaction if the repurchase price of the asset is equal to or exceeds the original selling price and is more than the expected market value of the asset.

An arrangement is to be considered as a sale of a product with a right of return, if the customer has a repurchase right at an amount less than the original selling price (or greater than or equal to the original selling price but less than the expected market value), but does not have a significant economic incentive to exercise that particular right.

Principal versus agent

Entities often involve third parties while providing goods and services to their customers. Management needs to assess, for each performance obligation within a contract, whether the entity is acting as the principal or as an agent. in such arrangements. An entity recognises revenue on a gross basis if it is the principal in the arrangement, and on a net basis (that is, equal to the fee or the commission received), if it is acting as an agent. An entity is the principal in an arrangement if it obtains control of the goods or services of another party in advance of transferring control of those goods or services to a customer. On the other hand, it is an agent if its performance obligation is to arrange for another party to provide the goods or services.

An entity will need to evaluate if and when it obtains control. If it obtains the legal title of a product only momentarily before the title is transferred to the customer, this does not necessarily indicate that the entity is acting as the principal in the arrangement. Indicators that the entity is an agent include the following:

- **Fulfillment:** The entity does not have primary responsibility for fulfillment of the contract.
- **Inventory risk:** The entity does not have inventory risk at any point during the transaction (that is, before the order, during shipment, or upon return).
- **Pricing:** The entity does not have discretion in establishing prices for the other party's good or service.
- **Credit risk:** The entity does not have customer credit risk for the amount of the receivable.
- **Commission:** The entity's consideration is in the form of a commission.

The indicators in the revenue standard are similar to the current guidance in U.S. GAAP and IFRS. However, the specific requirement for the entity to obtain control differs from current guidance. The revenue standard does not weigh any of the indicators more heavily than others, unlike existing U.S. GAAP. New and evolving business models, especially related to internet transactions, have resulted in an increased focus in this area. We expect that entities will continue to apply judgment to assess whether to recognize revenue on a gross or net basis for many of these transactions, similar to today.

Rights of return

An entity will account for the sale of goods with a right of return by recognising revenue for the consideration it expects to be entitled to (considering the products expected to be returned), and a liability for the refund it expects to pay to customers, similar to the current accounting guidance under the US GAAP as well as the IFRS. Amounts are updated for changes in expected returns for each reporting period. Exchanges by customers for products of the same type, quality, condition, as well as price are not considered as returns. The entity will

recognise an asset and the corresponding adjustment to the cost of sales for the right to recover goods from customers. The asset is initially measured at the original cost of goods less any expected costs to recover those goods. Impairment is assessed at each reporting date. The entity needs to present the asset separately from the refund liability (that is, it should not present a net balance in its financial statements).

Warranties

An entity accounts for a warranty as a separate performance obligation if the customer has the option to purchase the warranty separately. It accounts for a warranty as a cost accrual if it is not sold separately, unless the warranty is to provide the customer with a service, in addition to the assurance that the product complies with agreed-upon specifications, in which case, the additional service is accounted for a separate performance obligation, this assessment will require judgment.

> The guidance on accounting for warranties is generally consistent with current guidance in the US GAAP as well as IFRS. However, it might be challenging to separate a single warranty that provides both a standard warranty as well as an additional service in some arrangements. The management will have to develop processes in order to estimate standalone selling prices and allocate the transaction price between the performance obligations in the arrangement when such services are not sold separately.

Non-refundable upfront fees

Some entities charge a customer a non-refundable fee at the beginning of an arrangement. Examples include set-up , activation, and joining fees. The management needs to determine whether a non-refundable upfront fee relates to the transfer of a promised good or service to a customer. A non-refundable upfront fee might relate to an activity undertaken at or near contract inception. Similar to the current accounting guidance under the US GAAP and IFRS, the activity does not result in the transfer of a promised good or service to the customer, unless the entity has satisfied a separate performance obligation. The upfront fee is recognised as revenue when goods or services are provided to the customer in the future. Depending on the nature of the fee, the period of revenue recognition can extend beyond the initial contractual period if the entity grants the customer the option to renew the contract and that option provides the customer with a material right.

Bill-and-hold arrangements

In a bill-and-hold arrangement, an entity bills a customer for a product, but retains physical possession of the product until a later date. Revenue is recognised upon transfer of control of the goods to the customer (that is, the customer has the ability to direct the use of and obtain substantially all of the remaining benefits from the asset). In addition to applying the control guidance in the standard, all of the following requirements must be met in order to recognise revenue in a bill-and- hold arrangement:

- The reason for the customer requesting the bill-and-hold arrangement is substantive.
- The product is ready for physical transfer to the customer and separately identified as the customer's product.
- The entity cannot use the product or direct the product to another customer.

> The list of indicators for bill-and-hold transactions are generally consistent with the current guidance under the IFRS. There might be situations where revenue could get recognised earlier as compared to the current US GAAP standards for bill-and-hold arrangements since there is no longer a requirement for the vendor to have a fixed delivery schedule from the customer in order to recognise revenue.

Disclosures

The revenue standard requires several disclosures intended to enable users of financial statements to understand the nature, amount, timing, as well as the uncertainty of revenue and the related cash flows. These disclosures include qualitative as well as quantitative information about contracts with customers and significant judgments made in applying the revenue guidance. Some of these disclosures include, disclosure of disaggregated revenue into categories, for example, . products, services, geographies, markets etc, reconciliation of contract asset and liability balances, information about performance obligations and assets recognised from the costs to obtain or fulfill a contract.

> Disclosure requirements are significantly greater than existing disclosure requirements for revenue under the US GAAP and IFRS standards. The revenue standard could add significant disclosures for interim financial statements as well. This can require new systems, processes as well as internal controls in order to capture information that has historically not been required for financial reporting purposes, particularly in interim financial statements. The standard includes several examples that illustrate specific aspects of the disclosure requirements. However, entities will need to tailor the sample disclosures for their specific facts and circumstances.

Thinking ahead

Entities will apply the revenue standard in the first interim period within annual reporting periods beginning on or after 15 December 2016 (US GAAP public entities) and 1 January 2017 (IFRS). For example, 1 January 2017 will be the date of initial application for an entity following a 31 December 2017 year-end. Earlier adoption is not permitted under the US GAAP, but is permitted under the IFRS. The standard will be effective for annual reporting periods beginning after 15 December 2017, for non-public entities under the US GAAP with earlier application permitted, however, no earlier than the effective date for public entities.

An entity can apply the revenue standard retrospectively to each prior reporting period presented (full retrospective method) or retrospectively with the cumulative effect of initially applying the standard recognised at the date of initial application in retained earnings (simplified transition method). An entity that elects to use the simplified transition method must disclose this fact in its financial statements. An entity using this method will apply the revenue standard only to contracts that are not completed (that is, the entity has not transferred all of the goods or services promised within the contract) as of the date of initial application. Entities are also required to disclose the amount by which each financial statement line item is affected by the adoption in the year of initial application.

The simplified transition method is intended to reduce the transition time and effort for preparers that choose this option. The requirement for entities to disclose the impact to each financial statement line item will effectively result in an entity applying both the new revenue standard as well as the previous revenue guidance in the year of initial application.

The boards provided a longer than typical period of time for transition because of the pervasiveness of the standard and the importance of reporting revenue. It is intended to ensure that there is sufficient time for entities that wish to use the full retrospective method as well as for those that use the simplified transition method, given the concerns of preparers about the amount of effort that the adoption of the standard might require. Full retrospective application provides stronger trend information that some entities might prefer to provide to investors, so it was important to provide sufficient time for these preparers to transition.

Service concession arrangements

In recent times, service concession agreements have significantly increased for the government as well as other regulatory bodies to undertake infrastructure projects as part of public private partnership initiatives. These arrangements are considered economically viable as well as beneficial in the larger public interest and are quite commonly seen in the infrastructure space of roadways, bridges, airports and water distribution facilities among others. The arrangements are commonly termed as build-operate-transfer (BOT), design-build-operate-transfer (DBOT), etc.

These arrangements generally comprise various deliverables. In certain cases, existing facilities are given to private entities for renovation or expansion and operation or creation of new assets along with operation and maintenance.

In either case, the primary condition being handing over of specific assets to the government or regulatory body at the end of the contract tenure. Surprisingly, although such contracts are now quite widespread, currently there is no accounting standard or other pronouncement under the Indian GAAP to address accounting issues arising from such arrangements.

The ICAI had issued an exposure draft of the Guidance Note on Accounting for Service Concession Arrangements (Exposure Draft of Guidance Note) in October 2008 and had proposed an effective date of 1 April 2009. However, this guidance note has not yet been made effective. The ICAI has also included guidance on service concession arrangements as appendices in the EDs of Ind-AS 11: Construction Contracts and Ind-AS 115 : Revenue from Contracts with Customers, the effective dates of which are yet to be announced.

In the absence of specific guidance under the Indian GAAP, diverse accounting practices with respect to certain elements of service concession arrangements are noted.

Identifying a service concession arrangement

An important feature of a service concession arrangement is the public service nature of the obligation undertaken by the operator. The arrangement contractually obliges the operator to provide services to the public on behalf of the public sector entity. Other common features generally include the following:

- The party that grants the service arrangement (the grantor) is a public sector entity, including a governmental body.
- The operator is responsible for at least part of the management of the infrastructural facilities and related services, and does not merely act as an agent on behalf of the grantor.
- The contract sets initial prices to be levied by the operator for utilisation of infrastructural facilities and regulates price revisions over the period of the service arrangement.
- The operator is obliged to hand over infrastructural facilities to the grantor in a specified condition at the end of the period of the arrangement, for little or no incremental consideration, irrespective of which party initially financed it.

Simplifying the components

Broadly, every service concession arrangement will comprise the following elements:

- Rights of the operator on the assets created
- Recognition and measurement of consideration
- Operation services

Rights of the operator on the assets created

This is one of the key areas, relating to service concession arrangements, where diverse practices may exist. The most commonly observed practice is to treat the assets created for the purpose of the arrangement as the entity's own tangible assets, since expenditure is being incurred for construction of tangible assets. Further, although the assets are not owned by the entity, it is able to physically control the assets as well as derive benefits by way of toll fees or annuity over the concession period.

Supporters of this accounting treatment will refer to the definition of fixed asset as stated under AS 10: Accounting for Fixed Assets to justify such capitalisation, which mentions that, 'Fixed asset is an asset held with the intention of being used for the purpose of producing or providing goods or services and is not held for sale in the normal course of business.' Such tangible assets are then subsequently depreciated over the concession period.

Another practice, though not as common is to capitalise the actual expediture incurred towards construction or expansion as intangible assets. The rationale being that such an expenditure confers a right on the entity to collect the toll fee or annuity in the future, and is therefore 'intangible' in nature, thereby meeting the criteria for recognition as an intangible asset under AS 26: Intangible Asset. Such intangible assets are then subsequently amortised over the concession period on a straight line or another systematic basis.

The third practice is where entities follow the guidance under IFRIC 12 or Exposure Draft of Guidance Note, which clearly states that such infrastructural facilities need not be recognised as property, plant and equipment of the operator because the contractual service arrangement does not convey it the right to control the use of the public service infrastructural facilities. The operator only has access to operate the infrastructural facilities to provide the public service on behalf of the grantor in accordance with the specific terms in the contract.

A similar view, of not recognising expenditure incurred towards construction of assets not owned by an entity (although not in relation to a service concession arrangements) has been taken by the Expert Advisory Committee (EAC) of the ICAI in its recent opinions. These opinions specifically state that expenditure incurred on assets not owned by the entity need to be charged off to revenue in the period in which it is incurred.

In view of these opinions, the acceptability of the first practice mentioned above is unclear.

Recognition and measurement of consideration

Where an entity follows the accounting treatment of capitalising the constructed asset either as a tangible or an intangible asset, it is based on the premise that the entity is constructing or expanding the asset in order to generate future cash flows by providing services, either by collection from users (for example, toll charges) or annuities. Consequently, revenue is not bifurcated between construction services and operation services elements, resulting in the entire revenue being recognised as operation services based on AS 9: Revenue Recognition. Accordingly, no revenue is recognised during the construction period.

In contrast, an entity that follows the principles of IFRIC 12 or Exposure Draft of Guidance Note, will recognise revenue in accordance with AS 7: Construction Contracts for construction or expansion services and AS 9: Revenue Recognition for operation and maintenance services element of the arrangement. Further, in such cases, where the operator performs more than one service under a single arrangement, the consideration is generally allocated based on the relative fair values of the elements delivered, when the amounts are separately identified. The assessment of relative fair values for these service components is often quite complex due to practical difficulties such as lack of comparable projects, significant estimates of future usage, collections, etc.

Further, the consideration may be considered as a right to either of the following:

- A financial asset
- An intangible asset

The operator recognises a financial asset to the extent that it has an unconditional contractual right to receive cash or another financial asset from or at the direction of the grantor for construction services. The operator recognises an intangible asset to the extent it receives a right (a license) to charge users of the public service. Accordingly, in such cases, based on the contractual arrangement, the entity can either recognise a financial asset or intangible asset or both. It is to be noted that depending on whether the consideration is right to financial asset or an intangible asset, the amount of reported revenue and costs can be significantly different even though the net profits may be similar.

Operation services

Where an entity does not bifurcate the consideration between construction and operation services, the entire amount is attributed to the operation services, generally resulting in the usage charges (for example, toll fees) being recognised when the right to charge the users arises and/or the annuities being recognised on a straight line or another systematic basis over the concession period. In contrast, for an entity that follows the guidance under IFRIC 12 or Exposure Draft of Guidance Note, only the revenue attributable to the operations component will get recognised on the above basis.

Summing up

As observed, due to diversity in practice, financial performance and position of entities having significant service concession arrangements may not be comparable requiring a need for an accounting standard or a final guidance note. Also, diversity in accounting practices between the US GAAP and IFRS may continue to exist.

International practices

Under the IFRS, there is specific guidance in IFRIC 12 - Service Concession Arrangements. Until recently, the US GAAP did not contain specific guidance for the accounting of service concession arrangements. Depending on the terms of a service concession arrangement, an operating entity may or may not conclude that it meets the lease criteria.

However, in January 2014, the Financial Accounting Standards Board (FASB) issued an Accounting Standards Update (Update) –No. 2014 -05 Service Concession Arrangements.

Topic 853 specifies that an operating entity should not account for a service concession arrangement within the scope of the update as a lease. Further, an operating entity should refer to other applicable topics to account for various aspects of a service concession arrangement. The amendments also specify that the infrastructure used in a service concession arrangement should not be recognised as property, plant, and equipment of the operating entity.

This update is applicable to an operating entity of a service concession arrangement entered into with a public-sector entity grantor when the arrangement meets both of the following conditions:

- The grantor controls or has the ability to modify or approve the services that the operating entity must provide with the infrastructure, to whom it must provide them, and at what price.
- The grantor controls, through ownership, beneficial entitlement or otherwise, any residual interest in the infrastructure at the end of the arrangement term.

The amendments are already effective for a public business entity for annual periods, and interim periods within those annual periods, beginning after 15 December 2014. For an entity other than a public business entity, the amendments are effective for annual periods beginning after 15 December 2014, and interim periods within annual periods beginning after 15 December 2015. Also, early adoption is permitted.

Amendments within this update are consistent with the IFRS to the extent that service concession arrangements are not considered leases. However, the remaining guidance under IFRIC 12 is not incorporated under the US GAAP, which could result in divergence in accounting treatment.

Fraud and Companies Act, 2013

Prior to the Companies Act. 2013 (the 2013 Act), the subject of fraud has generally been discussed and defined within the accounting and auditing books. Now, it has been given a legal definition in section 447 of the 2013 Act, wherein the definitions mentions, *"fraud in relation to affairs of a company or a body corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss".* Within the definition, the term, 'wrongful gain' means gain by unlawful means of property to which the person gaining is not legally entitled and 'Wrongful loss' means the loss by unlawful means of property to which the person losing is legally entitled. The definition of fraud is thus quite wide and may include corrupt practices, deceit, conflicts of interest as well as bribery.

Section 447 primarily prescribes the punishment in case of fraud, which includes imprisonment for a term not less than six months, but which may extend to ten years, and fine not less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud. Also, where the fraud in question involves public interest, the term of imprisonment shall not be less than three years. The 2013 Act has also accorded statutory status to the serious fraud investigation office (SFIO), which now has the power to arrest in respect of certain offences for fraud.

Key provisions relating to fraud and its applicability and responsibility for management and board of directors

Directors' responsibility statement: Section 134(5) of the 2013 Act requires that the directors' responsibility statement (part of the director's report of a company) should affirm that directors have taken proper as well as sufficient care for the maintenance of adequate accounting records in accordance with the provisions of the 2013 Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities.

Vigil mechanism: Section 177 of the 2013 Act, requires audit committees for listed companies and certain companies which have accessed public deposits or borrowings are now required to establish a vigil or whistleblower mechanism for directors as well as employees to report their genuine concerns.

Restatement of accounts: The 2013 Act and the related draft rules also permits reopening of the books of account and voluntary revision of financial statements or the director's report, after seeking prior approval of the National Company Law Tribunal (NCLT), if there is reason to believe that the earlier relevant accounts were prepared in a fraudulent

manner or if the affairs of the company were mismanaged casting doubt on the reliability of the financial statements. In case a company is required to restate its financial statements pursuant to fraud or non-compliance with any requirement under the 2013 Act and the draft rules made thereunder, the excess remuneration paid (including stock options) to any past or present managing director or whole-time director or manager or chief executive officer who, during the period for which the financial statements have been restated, has acted in such capacity, can be recovered by the company.

Other provisions: There are now several other specific provisions of the 2013 Act referring back to punishment for fraud under section 447, some of which are as follows:

- Where a person furnishes any false or incorrect particulars or suppresses any material information in relation to incorporation of a company filed with the registrar.
- Where a prospectus issued for allotment of securities includes any untrue or misleading statement including omission of any matter which is likely to mislead or fraudulently induce persons to invest money.
- Where a company fails to repay the deposit or any interest within the applicable time limits, including where it is proved that such deposits were accepted with the intent to defraud the depositors or for any fraudulent purpose.
- Where the Tribunal is satisfied that the auditor of a company has, directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers.
- Where in the course of an inquiry or inspection, it is ascertained that the business of a company has been or is being carried on for a fraudulent or unlawful purpose or with intent to defraud its creditors, members or any other persons.
- If in any return, report, certificate, financial statement, prospectus, statement or other document required by, or for, the purposes of any of the provisions of Act or the rules made there under, any person makes a statement (a) which is false in any material particulars, knowing it to be false or (b) which omits any material fact, knowing it to be material.

Specific additional reporting responsibilities of auditors

Currently, the Companies (Auditor's Report) Order 2003 (CARO), requires the auditor to report on whether any fraud on or by the company has been noticed or reported during the year and if yes, the nature and the amount involved is to be disclosed in the auditor's report. The ICAI has issued the Statement on Companies (Auditor's Report) Order 2003 (Statement) which provides guidance to the auditor on reporting of frauds. This statement states that although fraud is a broad legal concept, the auditor is concerned with fraudulent acts that cause a material misstatement in the financial statements. Further, auditors are not required to make legal determinations of whether fraud has actually occurred or not. This is also in line with the responsibilities of the auditor laid out by the Standard on Auditing (SA) 240, The auditor's responsibilities relating to fraud in an audit of financial statements.

However, section 143 (12) of the 2013 Act has significantly expanded these responsibilities, requiring an auditor to act as a whistleblower. Accordingly, if in the course of the performance of his duties as auditor, he has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees then it is required to be reported to the central government within a period not exceeding 60 days from the date of knowledge. Prior to this reporting, the auditor is required to obtain reply or observations from the board or audit committee within a period of 45 days.

A closer look at the Form ADT- 4 under the rules for reporting by the auditor reveals that the auditor is required to certify a declaration containing the following particulars:

- Details of the suspected offence involving fraud, estimated amount involved, basis on which fraud is suspected and period during which the suspected fraud has occurred.
- Particulars of the officers or employees who are suspected to be involved in the commission of the offence, if any.
- Date of sending report to the board or audit committee, date of reply and its summary (in addition to attaching a copy).
- Whether the auditor is satisfied with the reply of the board or the audit committee and details of the steps, if any, taken by the company in this regard.
- Any other relevant information.

Practical issues to be considered

- Reporting on fraud directly to the central government merely on the basis of available information, without complete evaluation or conclusion on the matter by the company's board or audit committee may be premature which could not only result in unintended consequences but is not clear how effective will it be in serving the desired purpose - it is quite possible that all the facts are not known during the initial stages of an investigation.

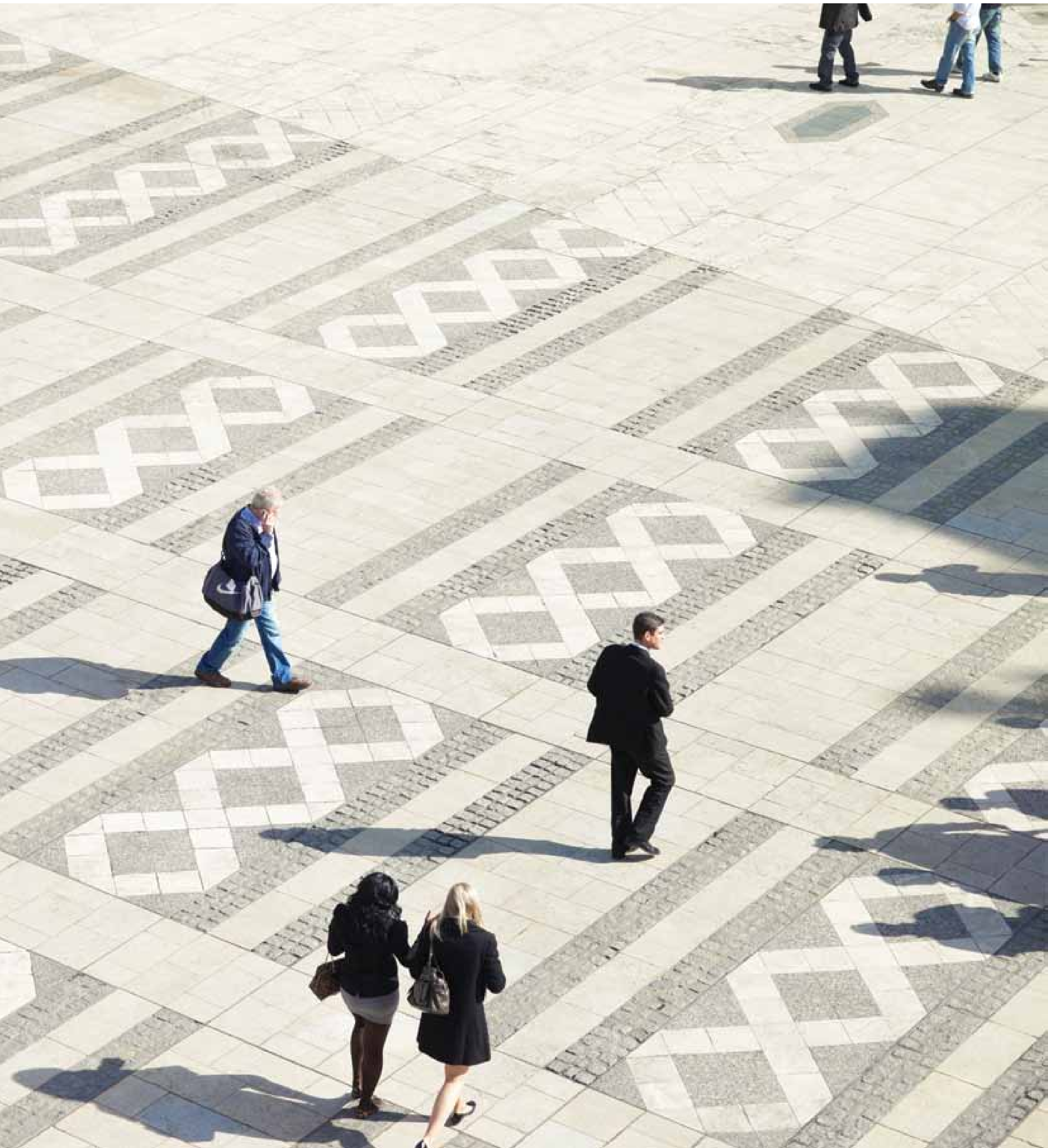
It is to be noted that globally, the responsibility of auditors are included as part of auditing standards in relation to audits of the financial statements or internal control over financial reporting, that is, material misstatements in the financial statements due to fraud. Further, auditors report to the management and audit committees or board of directors so that appropriate investigation can be done and remedial actions can be taken.

For example in the US under section 10A of the Securities and Exchange Act of 1934, auditors of public companies are required to report to the Securities and Exchange Commission (SEC) only when, during the course of their audit an auditor detects likely illegal acts that have a material impact on the financial statements and appropriate remedial action is not being taken by management or the board of directors. The report under section 10A is to be made within a period of one day and are to assist the SEC in performing its enforcement responsibilities and therefore, the auditors' reports are non-public in nature.

- Reporting of all frauds, without considering the concept of materiality, may become a very cumbersome process both for the audit committees as well as the auditors.
- Since the auditor is required to report both concluded frauds and those which are 'being committed', it may so happen that after the auditor has reported a suspected fraud, the investigation result may conclude otherwise.
- The auditor is required to respond to a yes or no question to determine if he is satisfied with the response from the Board or the Audit Committee. In case of alleged frauds, it is likely that the answer to this is highly subjective and judgmental and requires professional guidance.
- The manner in which frauds reported by auditors will be dealt with by the Ministry of Corporate Affairs is not clear.
- We understand that the ICAI is in the process of drafting guidance for auditors to be considered while reporting such matters.

In conclusion

Various investor protection and corporate governance provisions introduced under the 2013 Act have good intentions and will require the boards as well as the management to take a closer look and implement enterprise risk management and other vigil mechanisms with renewed vigour. This also calls for auditors and audit committees to increase their engagement and initiate a two-way dialogue on matters related to internal controls and risks. However, at the same time the currently enacted provisions pose some practical challenges and unintended implications, which will hopefully get addressed through professional guidance.



Related party relationships and transactions

Related party relationships and transactions continue to draw the attention of stakeholders, audit committees, regulators and auditors. This topic is on the top of almost every corporate governance agenda being a common area where frauds have been perpetrated. This is also where due to potential conflict of interest, transactions may not be at arm's length; consequently having an adverse impact on of shareholders' interest.

In this article, we will discuss some of the key provisions of the Public Company Accounting Oversight Board's (PCAOB or the Board) newly adopted final auditing standard no 18, 'Related parties and related amendments to other auditing standards' (the standard). This new standard and amendments, adopted by the PCAOB on 10 June 2014, are intended to strengthen auditor performance requirements not only regarding related parties, but also other significant unusual transactions, financial relationships and transactions with executive officers.

Background

This standard is intended towards strengthening auditor performance requirements for identifying, assessing, and responding to the risks of material misstatement associated with a company's relationships and transactions with its related parties. The Board determined that the existing standards in these areas do not contain required procedures and are not sufficiently risk-based, which can lead to inadequate auditor effort. Additionally, the Board's inspection and enforcement activities indicate that there are continuing weaknesses in auditors' scrutiny in these areas.

The Board believes that the standard and amendments, which are aligned with the risk assessment standards, represent a cohesive audit approach that will contribute to audit effectiveness and provide opportunities for an efficient implementation.

It is relevant to note that related party transactions are now extensively covered under the Companies Act, 2013. It defines the term 'related party' which is significantly wider than the definition under the accounting standards. The different types of transactions which are now subjected to compliance have also been expanded as compared to the Companies Act, 1956. Further, approval of the Board and the shareholders are required, where the related party transactions are not in 'ordinary course of business and are not on an 'arm's length basis'. The Audit Committee and the Board are to evaluate whether the transactions are being conducted on an arm's length basis.

Relationships and transactions with related parties

The standard has been designed to strengthen auditor performance requirements by setting forth specific procedures for auditor's evaluation of a company's identification of, accounting for and disclosure of relationships and transactions between the company and its related parties. Among other things, the standard requires the auditor to take the following steps:

- Perform specific procedures to obtain an understanding of the company's relationships and transactions with its related parties, including obtaining an understanding of the terms and business purposes (or the lack thereof);

- Evaluate whether the company has properly identified its related parties as well as the relationships and transactions with related parties by performing procedures to test the accuracy and completeness of management's identification, taking into account information gathered during the audit;
- Perform specific procedures if the auditor determines that a related party or relationship or transaction with a related party previously undisclosed to the auditor exists;
- Perform specific procedures regarding each related party transaction that is either required to be disclosed in the financial statements or can potentially be a significant risk. In this regard, the auditor has to (i) read the underlying documentation and evaluate whether the terms and other information about the transaction are consistent with the explanations from inquiries and other audit evidence about the business purpose (or the lack thereof) of the transaction (ii) determine whether the transaction has been authorised and approved in accordance with the company's established policies and procedures regarding the authorisation and approval of transactions with related parties (iii) determine whether any exceptions to the company's established policies or procedures were granted (iv) evaluate the financial capability of related parties with respect to significant uncollected balances, loan commitments, supply arrangements, guarantees and other obligations;
- Communicate to the audit committee the auditor's evaluation of the company's identification of, accounting for and disclosure of its relationships and transactions with related parties, and other significant matters arising from the audit regarding the company's relationships and transactions with related parties. The auditor is also required to inquire about the audit committee's understanding of the company's relationships and transactions with related parties that are significant to the company; and whether any member of the audit committee has concerns regarding relationships or transactions with related parties and, if so, the substance of those concerns.

Some of the key improvements from the existing standards include:

- Adding specific procedures designed to assist the auditor in identifying red flags that indicate potential risks of material misstatement in related party transactions;
- Requiring the performance of specific procedures to obtain an understanding of not only the terms, but also the business purpose (or the lack thereof) of related party transactions;
- The existing standards place primary emphasis on the adequacy of disclosure of related party transactions, whereas this new standard requires that the auditor evaluate both the accounting for, and disclosure of related party transactions;
- Increased communication with the audit committee including specific inquiries;
- Intended to enhance the auditor's evaluation of the business purpose of significant unusual transactions by, among other things, expanding the factors considered by the auditor in evaluating whether the business purpose (or the lack thereof) indicates that such transactions may have been entered into to engage in fraudulent financial reporting or conceal misappropriation of assets;
- Emphasising accounting and disclosure: The new requirements emphasise that the auditor must evaluate whether the financial statements contain information regarding significant unu sual transactions essential for a fair presentation in conformity with the applicable financial reporting framework.

- The basic procedures for obtaining information for evaluating significant unusual transactions include the following:
- reading the underlying documentation relating to significant unusual transactions and evaluating whether the terms and other information about the transaction are consistent with explanations from inquiries and other audit evidence about the business purpose (or the lack thereof) of the transaction;
- determining whether the transaction has been authorised and approved in accordance with the company's established policies and procedures;
- evaluating the financial capability of the other parties to the transaction with respect to significant uncollected balances, guarantees and other obligations.

The basic procedures are designed to assist the auditor in identifying red flags that indicate potential risks of material misstatement.

Financial relationships and transactions with executive officers

Other amendments modify existing standards, require the auditor to perform specific procedures to obtain an understanding of the company's financial relationships and transactions with its executive officers, including compensation. A company's executive officers are in a unique position to influence a company's accounting and disclosures. A company's financial relationships and transactions with its executive officers (executive officer compensation, for instance) can create incentives and pressures for them to meet financial targets, which can result in risks of material misstatement to a company's financial statements. The amendments do not require the auditor to make any determination regarding how reasonable the compensation arrangements or recommendations regarding compensation arrangements.

Next steps

The standard and amendments will be effective, subject to SEC approval, for audits of financial statements for fiscal years beginning on or after 15 December 2014, including reviews of interim financial information within these fiscal years.

Clause 49: A welcome breather but intrigue remains

The Companies Act 2013 (the 2013 Act) intends to significantly raise the bar on corporate governance in India and align it with global standards. It makes a paradigm shift; from a control-based regime to a self-governance regime. One of the chief objectives of the 2013 Act was to encourage disclosure and transparency while positively impacting the ease of doing business in India. The 2013 Act explores many areas of corporate governance including independent directors, nomination and remuneration committee, etc. which until now were in the domain of the SEBI.

The SEBI's revised Clause 49 (C 49) of the Equity Listing Agreement, effective from 1 October, 2014 went a step further and prescribed stricter requirements for listed companies. There was an overlap in several areas causing confusion and duplication. The SEBI received representations from market participants including companies and industry associations, highlighting practical difficulties in ensuring compliance, seeking clarifications on the interpretation of provisions and suggesting options to ease the process of implementation.

The SEBI also proactively reached out to listed companies in order to assess their level of preparedness for the new regime. The recent amendment in C 49 is a logical consequence of the broad consultation process with stakeholders, undertaken by SEBI [Circular CIR/CFD/POLICY CELL/7/2014 dated 15 September, 2014].

Amendments in C 49

The amendment provides a welcome respite for corporate India. The SEBI has rationalised the approval process for related party transactions (RPTs) by easing the requirement of prior approval of all related party transactions by the audit committee. Since audit committees meet after a gap of time, companies with large volumes of RPTs were faced with implementation issues. By providing for omnibus approval with checks and balances, an attempt has been made to ensure that authority is exercised with accountability and also considering practical aspects. The Act and C 49 have entrusted greater responsibility to the audit committee with regard to RPTs.

Additionally, while C 49 provides the option of granting omnibus approvals, the onus to ensure compliance with prescribed norms, continues to rest with the audit committee. The policy for dealing with RPTs, including the manner of ascertaining material RPTs now becomes a key guiding document.

Another positive is a broader view of the term 'transaction' to include 'a single transaction or a group of transactions in a contract'. This provides flexibility to approve a contract containing multiple transactions in one go. Revision of the materiality threshold for RPTs will also work to the advantage of corporates. With respect to definitions, C 49 is much wider, since the term 'related party' has been defined to include both–the definition under the 2013 Act as well as Accounting Standard 18: Related Party Disclosures.

Apart from the area of RPTs, the amendment also aligns the transition period given for complying with the requirement of appointing a woman director with the 2013 Act and has now revised the date to 1 April, 2015 from 1 October, 2014.

Open areas of harmonisation

While harmonisation has been achieved in several areas, certain differences continue. One such conflicting provision is the exclusion of all related parties from voting in a meeting irrespective of whether they are a party to the specific contract under consideration. This has negated the relaxation which the MCA had given by allowing shareholders who are not party to the contract, to exercise their vote. For example, removing the right of a holding company (related party) to vote on a transaction even where it is not an interested party can cause hardship to companies.

With the implementation of the new regime being around the corner, a number of listed companies have already initiated steps to make the transition. There may not be enough time for companies to make further changes. One therefore hopes that there would be a relaxation in timelines in respect of some of the clauses.

Dilemma

Interestingly, in some areas, C 49 is more liberal than the 2013 Act. For example, while the 2013 Act allows no pecuniary relationships for independent directors, C 49 limits this by prohibiting only material relationships. Similarly, in respect of RPTs, C 49 provides for omnibus approvals by the audit committee which is more favourable as compared to the 2013 Act. In such scenarios, it is expected that eventually consistency between the two legislations should be ensured. However, as of now, since a company has to comply with both regulations, a relaxation under one may not be of much consequence.

The way forward

The recent amendment to C 49 is a positive step in consonance with the philosophy of the government and the regulator of working towards more empowerment and self-governance. However, there is a lot of ground still to be covered before we get to a consistent and harmonious regime which promotes corporate governance. Continuing consultations with all stakeholders coupled with a pragmatic approach which irons out grey areas and removes conflicts will go a long way towards achieving this.

OECD finalizes guidance on transfer pricing documentation and country-by-country reporting

On September 16, 2014 the Organization for Economic Cooperation and Development (OECD) finalized its guidance in relation to transfer pricing documentation and country-by-country (CbC) reporting. The final report is broadly consistent with the Discussion Draft released by the OECD on January 30, 2014 although it has pared back some proposals in response to concerns of the business community and clarified a number of questions raised by the Discussion Draft.

The guidance from this report will replace the transfer pricing documentation guidance contained in Chapter V of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Guidelines). In summary, this guidance seeks to provide a coherent and consistent framework under which multinational enterprises (MNEs) should prepare global transfer pricing documentation, while simultaneously improving the ability of tax authorities to make better informed risk assessments and to conduct better targeted transfer pricing audits. Some of the details around implementation mechanisms, including timing, will be developed further over the next few months and for many OECD countries there may be a need to implement this new approach to transfer pricing documentation through changes to domestic law before this fully comes into effect. However, it is clear that there is a strong commitment to implement and this will represent a significant shift to the way in which MNEs currently prepare and renew transfer pricing documentation. In fact, the UK became the first country to formally commit to implementing the CbC report.

Background

In recent years, the OECD has grown increasingly concerned with the effectiveness of current transfer pricing documentation guidance. Particularly with the proliferation of diverse local transfer pricing documentation rules, tax payers have expressed concern that transfer pricing compliance costs in meeting each jurisdiction's specific requirements are becoming oppressive. Tax authorities, however have expressed the view that transfer pricing documentation currently being prepared is insufficiently informative for their risk assessment and tax enforcement needs, and provides an incomplete picture of taxpayers' global operations.

As such, the OECD has reiterated the three core overarching objectives of transfer pricing documentation, namely:

- Enabling taxpayers to make informed assessments of their compliance with the arm's length principle (with the OECD encouraging taxpayers to make these assessments prior to the filing of their income tax returns);
- Providing tax administrations with sufficient information to conduct an informed transfer pricing risk assessment; and
- Providing tax administrations with information to conduct transfer pricing audits (although noting they may need to supplement this with additional information as audits progress)

Three-tiered approach to transfer pricing documentation

Under the OECD's new guidance, MNEs will be required to prepare three-tiered transfer pricing documentation:

- **Tier 1:** a master file, containing specific information relevant for all MNE group members;
- **Tier 2:** a local file, referring specifically to material transactions of the local taxpayer; and
- **Tier 3:** a CbC report, containing high-level data with respect to the global allocation of the MNEs income and taxes and certain measures of economic activity

Implementation

The OECD is still in the process of determining how best to implement these new guidelines. In particular, it is continuing to deliberate how best to protect the confidentiality of commercially sensitive information, the most appropriate sharing mechanisms between tax authorities and an appropriate phase-in process.

A number of countries (including Argentina, Brazil, China, Colombia, India, Mexico, South Africa and Turkey) expressed the view that additional information should be included in the CbC report. In particular there was a desire to include information on related party interest payments, royalty payments and service fees. While this view was not taken up in the final report, the OECD has committed to regularly reviewing Chapter V, reassessing no later than 2020 (where it will reopen the debate on whether additional transaction by transaction reporting in the CbC template is desirable).

In the meantime, it is possible that there will be, effectively, a fourth-tier of documentation required to accommodate the additional information that some local countries will require in their tax return filing (eg., special transfer pricing information return)

The takeaway

While this report answered many of the questions posed by the Discussion Draft, the package continues to be heavily skewed towards tax authorities with respect to the amount of information and level of detail required. It seems unlikely that the improved consistency of reporting will materially reduce MNE compliance costs due to sheer increase in information required. Tax authorities with current tax return disclosure requirements may not eliminate their requirements or conform them to the OECD's new guidance. In addition, the upfront costs, in upgrading information systems to capture the new data required will be significant for many MNEs.

It is important for the business community and tax professionals to ensure an appropriate phase-in of this new approach to documentation. It is also advisable that MNEs review their internal processes and systems to confirm efficient and accurate capture of the increased information required by tax authorities.

Recent technical updates

The Companies Act, 2013

Companies (Cost records and Audit) Rules, 2014

The much awaited Companies (Cost records and Audit) Rules, 2014 have been issued and are applicable to large number of industries. These rules have been enforced from 30 June 2014.

Clarifications on the Rules prescribed under the Companies Act, 2013: Matters relating to the appointment and qualification of directors and independent directors

The MCA has issued certain clarifications with respect to the appointment and qualifications of directors and independent directors which include issues such as the meaning of 'pecuniary relationship' and the appointment of independent directors for a tenure of less than five years among others.

Clarifications with regard to Corporate Social Responsibility (CSR) provisions under section 135 of the Companies Act, 2013

There were several issues with respect to CSR provisions which have now been clarified by the MCA in the circular, beginning with providing the liberty to interpret various activities listed in Schedule VII liberally. Further, issues such as expenditure by holding companies, whether employee costs for those involved in CSR activities can be considered as CSR expenditure, meaning of registered trusts in states where registration of trusts is not mandated, among others.

Clarification on applicability of requirement for resident director

It has been clarified that the period to be taken into account for compliance with these provisions will be the remaining period of the calendar year 2014 (1 April to 31 December).

Therefore, on a proportionate basis, the number of days for which the director(s) needs to reside in India in 2014, shall exceed 136 days.

Regarding newly incorporated companies, it is clarified that the companies incorporated between 1 April 2014 and 30 September 2014, should have a resident director either at during the incorporation itself or within six months of incorporation. Companies incorporated after 30 September 2014 need to have the resident director from the date of incorporation.

Depreciation: Amendment to Schedule II

The MCA vide notification dated 29 August 2014, has amended Schedule II

to the Companies Act, 2014. The second amendment to Schedule II has made the following significant changes:

- The proviso to paragraph 3(i) has been amended to clarify that where a company adopts a useful life different from what is specified in Part C or uses a residual value different from limit specified above, the financial statements shall disclose such a difference and provide justification in this behalf duly supported by technical advice.
- The requirement for componentisation has been made voluntary for the financial year commencing on or after 1 April 2014 and mandatory in case of financial statements for financial years commencing on or after 1 April 2015.

Clarification on Accounting Standard 10:

The MCA has issued certain clarifications with respect to competitive bid power projects. This matter has been examined in consultation with the Accounting Standard Board (ASB)of the ICAI. The following are some of these clarifications:

- The circular clarifies that only expenditure that increases the worth of assets should be capitalised as a part of cost of fixed assets. Costs incurred during the extended delay in commencement of commercial production after the plant is otherwise ready does not increase the worth of the fixed assets. Such costs cannot, therefore, be capitalised.

- Accounting Standard 16, provides guidance with regard to part capitalisation where some units of a project are complete. In case one of the units of the project is ready for commercial production and is capable of being used while construction continues for other units, costs should be capitalised in relation to that part once the part is ready for commercial production.

Securities and Exchange Board of India

Extension of timeline for alignment of employee benefit schemes with the SEBI (ESOS and ESPS) Guidelines, 1999

SEBI vide circular no CIR/CFD/DIL/3/2013 dated 17 January 2013, inter alia, made certain amendments to the SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999 {'SEBI (ESOS and ESPS) Guidelines, 1999'} and employee benefit schemes involving securities of the company were required to be aligned with the SEBI (ESOS and ESPS) Guidelines, 1999. The timeline for alignment was subsequently extended vide aforesaid circulars dated 13 May 2013 and 29 November 2013. Meanwhile, following a consultative process, the SEBI Board has approved certain proposals for framing a new set of regulations concerning employee benefit schemes dealing in shares of the company. The new regulations shall come into force as and when notified. In view of the above, it has been decided to modify the said circular dated 29 November 2013 to extend the timeline for aligning existing employee benefit schemes with the SEBI (ESOS and ESPS) Guidelines, 1999 till the new regulations are notified. However, it is reiterated that the prohibition on acquiring securities from the secondary market shall continue till the existing schemes are aligned with the new regulations to be notified.

Corporate governance in listed entities: Amendments to Clauses 35B and 49 of the Equity Listing Agreement

SEBI has decided to review the provisions in the Listing Agreement in this regard with the objective to align them with the provisions of the Companies Act, 2013, adopt best practices on corporate governance and to make the corporate governance framework more effective. The full text of the revised Clause 35B of the Equity Listing Agreement is given in Part-A of the circular. The full text of the revised Clause 49 of the Equity Listing Agreement is given in Part-B of the circular.

The revised Clause 49 will be applicable from 1 October2014 The revised Clause 35B will be applicable to all listed companies and the modalities will be governed by the provisions of the Companies (management and administration) Rules, 2014.

Corporate Governance in listed entities - Amendments to Clause 49 of the Equity Listing Agreement

In order to further align the requirements of Clause 49 of the Equity Listing Agreement with Companies Act, 2013, SEBI has made certain amendments to the requirements relating to related party transactions, extended the period for appointment of a woman director to April 1, 2015 and others.

Global updates:

IASB issues IFRS 9 Financial Instruments: On 24 July 2014, the IASB published the complete version

of IFRS 9 Financial Instruments, which replaces most of the guidance in the IAS amended guidance for the classification and measurement of financial assets by introducing a fair value through other comprehensive income categories for certain debt instruments. It also contains a new impairment model which will result in earlier recognition of losses. No changes were introduced for the classification and measurement of financial liabilities, except for the recognition of changes in own credit risk in other comprehensive income for liabilities designated at fair value through profit or loss. It also includes the new hedging guidance that was issued in November 2013. These changes are likely to have considerable impact on entities that have significant financial assets, particularly financial institutions and will be effective for annual periods beginning on or after 1 January 2018, subject to endorsement in certain territories.

IASB issues amendments to IAS 16 and IAS 38: IASB has published an amendment to IAS 16 and IAS 38 on depreciation and amortization. In this amendment, the IASB has clarified that the use of revenue-based methods to calculate depreciation of an asset is not appropriate because the revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits embodied in the asset. The IASB has also clarified that revenue is generally presumed to be an inappropriate basis for measuring the consumption of the economic benefits embodied in an intangible asset. The amendment is effective for accounting periods starting on or after 1 January 2016 subject to EU endorsement.

FAF issues post-implementation review report on share-based payment standard:

The post-implementation review report (PIR) on Statement 123(R) identified many positive aspects of the share-based payment standard, including its usefulness to investors. The PIR team received input from investors and other financial statement users, as well as from preparers, auditors and academics.

FASB proposal to shed some light on the accounting for the cloud:

As a part of its simplification initiative, the Financial Accounting Standards Board (FASB) has issued a proposed Accounting Standards Update intended to simplify the accounting for the customer's fees paid in a cloud computing arrangement. The Update is intended to improve financial reporting of the fees paid by public and private companies and not-for-profit organisations who are customers in a cloud computing arrangement.

IESBA proposes strengthened auditor independence standard addressing long association in Ethics Code:

The Ethics Board approved for public comment changes to the provisions in Section 290 of the Code of Ethics for Professional Accountants (the Code) dealing with long association of senior personnel with an audit client. The Exposure Draft (ED) responds to several issues raised by stakeholders, including issues of independence in appearance. The ED broadly covers the following areas:

- Strengthening the general provisions that apply to all audit engagements
- Increasing the mandatory cooling-off period for the engagement partner on the audit of a client that is a public interest entity
- Strengthening the restrictions on the type of activities that can be undertaken by any former key audit partner during the cooling-off period
- Ensuring the concurrence of those charged with governance regarding the application of certain exception paragraphs.

IIRC releases papers on the role of assurance on Integrated Reporting:

The International Integrated Reporting Council (IIRC) has released 'Assurance on IR: An introduction to the discussion' and 'Assurance on IR: An exploration of issues' in order to help stakeholders understand the role of assurance and initiate a global discussion on its benefits and challenges. Together, the papers discuss issues such as, the nature of assurance and how different mechanisms contribute to credibility and trust; methodology issues dealing with, for example, future- oriented information, soft narrative and completeness of a report; and materiality, the reporting boundary and connectivity for assurance purposes. The IIRC believes these papers will act as catalyst for those with an interest in assurance to initiate and get involved in forums around the world during the second half of 2014, in order to debate the practical and technical challenges in ensuring credibility and trust in IR.

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Our offices

Ahmedabad
President Plaza, 1st Floor Plot No 36
Opp Muktidham Derasar
Thaltej Cross Road, SG Highway
Ahmedabad, Gujarat 380054
Phone +91-79 3091 7000

Bangalore
6th Floor, Millenia Tower 'D'
1 & 2, Murphy Road, Ulsoor,
Bangalore 560 008
Phone +91-80 4079 6000

Chennai
8th Floor
Prestige Palladium Bayan
129-140, Greams Road
Chennai 600 006
Phone +91-44 4228 5000

Hyderabad
Plot No. 77/A, 8-2-624/A/1
Road No. 10, Banjara Hills
Hyderabad - 500034, Telangana
Phone +91 40 4424 6000

Kolkata
Plot No.Y-14, 5th Floor,
Block-EP, Sector-V, Salt Lake
Kolkata 700 091, West Bengal
Phone +91-33 2357 9100 / 2357 7200

Mumbai
252, Veer Savarkar Marg,
Shivaji Park, Dadar,
Mumbai - 400 028.
Phone +91 22 66691000

New Delhi / Gurgaon
Building No. 10, Tower C, 17th and 18th Floor,
DLF Cyber City, Gurgaon, Haryana -122002
Phone +91-124-4620000

Pune
'Muttha Towers'
5th Floor, Suite No. 8,
Airport Road, Yerwada, Pune 411 006
Phone +91-20-41004444

www.pwc.in

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