PwC ReportingPerspectives

July 2019

Contents

Editorial

We are pleased to bring you the 19th edition of our quarterly newsletter, which covers the latest developments in financial reporting as well as other regulatory updates.

The Companies (Indian Accounting Standards) Amendment Rules, 2019, notified the new lease standard Ind AS 116, which is effective for annual reporting periods beginning on or after 1 April 2019. This edition discusses transition-related options and key practical expedients available to a lessee to transition to Ind AS 116 and our insights on this.

The Companies (Indian Accounting Standards) Second Amendment Rules, 2019, amended Ind AS 12, Income Taxes, to provide guidance on accounting for uncertain tax positions and Ind AS 28 to clarify that Ind AS 109 applies to long-term interests in associates or joint ventures. We will elaborate on the implications of these amendments in this newsletter.

We also provide an overview of the clarifications issued by the Ind AS Technical Facilitation Group (ITFG) in its bulletin 19.

Finally, we have summarised other Indian and global regulatory updates. We hope you find this newsletter informative and of continuing interest to you.

We welcome your feedback on pwc.update@in.pwc.com

Transitioning to Ind AS 116, Leases

At a glance

Ind AS 116, the new lease standard, is applicable to Ind AS reporters for annual reporting periods beginning on or after 1 April 2019. Ind AS 116 replaces Ind AS 17, Leases, and corresponds to IFRS 16, Leases, issued by the International Accounting Standards Board (IASB). Ind AS 116 requires lessees to recognise virtually all leases (except for certain optional exemptions) on their balance sheets that reflect their right to use an asset for a period of time and the associated liability for payments.

Ind AS 116 provides a number of choices for determination of the transition method in applying the standard. The selected transition approach will impact a lessee in a number of financial and operational areas, including comparability of the financial statements in the year of adoption, the carrying amount of the assets and liabilities, the net profit in the years subsequent to the transition, Ind AS 116-related implementation costs or efforts and the extent of information required in transition disclosures.

This article discusses the transition options and key practical expedients available to a lessee to transition to Ind AS 116 and provides our insights on these.

1. What transition options are available under Ind AS 116?

Lessees can choose between a full retrospective application in accordance with Ind AS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors', and a simplified approach. The approach chosen must be applied consistently to all leases. Comparative information is not restated under the simplified approach. Instead, the cumulative effect of applying the standard is recognised as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) on the date of initial application of the standard. The date of initial application is the beginning of the annual reporting period in which an entity first applies Ind AS 116 (i.e. 1 April 2019 for March year-end entities).

The table below illustrates the application of the simplified approach

Balance sheet item	Measurement
Leases previously classified as operating leases	
Lease liability	Present value of the remaining lease payments, discounted using a lessee's incremental borrowing rate on the date of initial application of the standard
Right-of-use (ROU) asset	Retrospective calculation, using a discount rate based on the lessee's incremental borrowing rate on the date of initial application of the standard or Amount of lease liability (adjusted by the amount of any previously recognised prepaid or accrued lease payments relating to that lease) (The lessee can choose one of the alternatives on a lease-by-lease basis) **Reduced by** Impairment provision calculated under Ind AS 36, Impairment of Assets (or onerous provision under Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets by using the practical expedient discussed in section 3 below)
Leases previously classified as finance leases	
Lease liability	Carrying amount of the lease liability immediately before the date of initial application of the standard
ROU asset	Carrying amount of the lease asset immediately before the date of initial application of the standard

Example: Application of simplified approach

ABC obtains on lease an office building for a rental of INR 100 per annum. The lease term commenced on 1 April 2017 and the lease term is five years. Rentals are to be paid at the end of every year.

Under Ind AS 17, ABC classified the lease as an operating lease and the lease payments are recognised as an expense on a straight-line basis.

ABC applies Ind AS 116 using the simplified approach. It has a March year end. ABC's incremental borrowing rate is 10% per annum as on 1 April 2019 and 8% per annum as on 1 April 2017.

Lease liability

ABC calculates its lease liability as on 1 April 2019 (the date of initial application of Ind AS 116) by discounting the remaining lease payments (i.e. lease rentals payable over the balance lease term of three years). The discount rate applied is 10%, i.e. the incremental borrowing rate as on 1 April 2019. Accordingly, the lease liability recognised is INR 248.

ROU asset

1. Option A (Retrospective calculation, using a discount rate based on a lessee's incremental borrowing rate on the date of initial application)

   ABC calculates the carrying amount of an ROU asset on the date of commencement of the lease (1 April 2017) by discounting lease payments over the lease term of five years, using the incremental borrowing rate as at the date of initial application of Ind AS 116 (1 April 2019). The present value of lease rentals over the lease term of five years is INR 379. ABC depreciates the ROU asset on a straight line basis over the lease term. Accordingly, the carrying value of the ROU asset as on 1 April 2019 is INR 227 (INR 379/5*3). The difference between the ROU asset of INR 227 and the lease liability of INR 248 is debited to the retained earnings.

2. Option B (lease liability amount)

   Assuming that there are no prepaid or accrued lease payments, the ROU asset as on 1 April 2019 shall be equal to the lease liability of INR 248.

A lessee applying the simplified approach needs to make additional disclosures such as the explanation of any difference between its (i) operating lease commitments disclosed while applying Ind AS 17 at the end of the annual reporting period immediately preceding the date of initial application of Ind AS 116, discounted using the incremental borrowing rate on the date of initial application; and (ii) lease liabilities recognised in the balance sheet on the date of initial application.

However, there are certain additional practical expedients which a lessee can avail under the simplified approach of transition to Ind AS 116.

2. What are the practical expedients and exemptions available under Ind AS 116?

Irrespective of the choice of transition approach (application of the full retrospective or simplified approach), there are four key practical expedients and exemptions available for all lessees:

1. Entities are not required to re-assess whether their existing contracts contain a lease (as per Ind AS 116) on their transition to Ind AS 116. An entity can elect to apply the guidance on definition of a lease as per Ind AS 116 only to contracts entered into (or changed) on or after the date of initial application. For all other contracts, it can retain the assessment made under Ind AS 17 (i.e. a 'grandfathered' assessment).
2. Exemption from Ind AS 116 requirements for lease contracts with a lease term (as defined in Ind AS 116) of 12 months or less (short-term leases). This exemption is to be applied to the entire class of an underlying asset, if it is used.

Ind AS 116 defines a lease term as the non-cancellable period of a lease, together with the periods covered by an option to extend the lease if the lessee is reasonably certain of exercising this option and the periods covered by the option to terminate the lease if the lessee is reasonably certain of not exercising the option. When the lessee and the lessor each has the right to terminate a lease without seeking permission from the other party with no more than an insignificant penalty, the enforceable period of the lease ends at the earliest point of time at which both parties can leave the contract and its contractual obligations. Enforceability of a lease contract does not require assessment of what is reasonably certain.

There is no guidance in the standard on how to weigh the individual factors when determining whether it is 'reasonably certain' that a lessee will exercise an option. For example, consider a flagship store in a prime and much sought-after location. Significant judgement would be needed to determine whether the prime geographical location of the store or other factors (such as termination penalties and leasehold improvements) indicate that it is reasonably certain that the lessee will renew the store lease.

3. An accounting policy choice needs to be made to not separate non-lease components from lease components (which applies to an entire class of assets, if used). For example, a lessee that leases several machines (each of which meets the definition of a separate lease component) and also receives maintenance services from the lessor has two alternatives: the lessee can account for each lease component and each service component separately or it can decide to combine the lease of a machine and the maintenance service related to the lease, and account for this as a single lease component.
4. Exemption from Ind AS 116 requirements for lease contracts where the underlying asset is of low value (lease-by-lease basis).

Ind AS 116 does not define the term 'low value', but the Basis for Conclusion to IFRS 16 explains that the IASB had in mind assets with a value of US$ 5,000 or less when new. US$ 5,000 is, however, not a quantitative threshold, but an example the IASB has used to illustrate a general principle.

An entity needs to focus on the nature of an asset to assess whether a leased asset qualifies for exemption as a low-value asset. Examples of assets with a low value can include IT equipment (tablets and personal computers), office furniture or telephones. Cars do not qualify as low-value assets, because a new car would typically not be of low value. The types of assets that qualify for the low-value asset exemption might change over time if, due to technological or market-related developments, the price of a particular type of asset changes. A change in the US dollar foreign currency exchange rate or the inflation rate does not, by itself, affect whether an asset is within the scope of the exemption.

A leased asset can only qualify as a low-value asset if the lessee can benefit from it on its own value or together with other resources that are readily available, and if the asset is not highly dependent on or highly interrelated with other assets.

A lessee that applies either or both of the short-term or low value exemptions recognises the lease payments as expenses on a straight-line basis or another systematic basis that is more representative of the pattern of the lessee's benefit.

3. Are there any additional practical expedients available to a lessee applying the simplified approach of transition to Ind AS 116?

When applying the simplified approach, a lessee can also select one or more of the following key practical expedients (on a lease-by-lease basis) for previously classified operating leases:

1. Applying a single incremental borrowing rate (IBR) to a portfolio of leases with reasonably similar characteristics.
2. Relying on an onerous lease assessment performed in the last Ind AS 17 reporting period as an alternative to performing an impairment review on the date of initial application of Ind AS 116.

Example

A retailer leases 90 stores. Under Ind AS 17, these are classified as operating leases. Prior to its adoption of Ind AS 116, the retailer had decided that it would stop using 18 of the stores for trading and would sub-lease them to third parties. Therefore, it assessed whether the underlying lease contracts were onerous by applying the guidance in Ind AS 37 and concluded that for 10 of the lease contracts, a provision for onerous contracts was needed.

72 contracts: No assessment made

10 contracts: Assessment made; provision recognised

8 contracts: Assessment made; no provision recognised

On transition to Ind AS 116, the retailer chooses the 'simplified approach'.

On the date of the initial application of the standard, how does the retailer assess whether the ROU asset recognised for each contract needs to be impaired? In this example, the store is a separate cash-generating unit, as defined in Ind AS 36, Impairment of Assets.

Analysis

On the date of the initial application, the lessee needs to assess whether the ROU asset recognised for each lease contract needs to be impaired. The way in which this test is performed depends on whether the lessee has already made an assessment, based on Ind AS 37, before the transition.

Contracts for which the entity has already made an assessment based on the guidance in Ind AS 37

In the case of contracts for which the entity has already made an assessment, based on the guidance in Ind AS 37 (in this example, 18 contracts), paragraph C10(b) of Ind AS 116 allows it to rely on this assessment. If the entity decides to apply that practical expedient, it adjusts the ROU assets at the date of initial application by the amount of any provision for onerous contracts recognised immediately before the date of initial application.

Looking at the example, this means that:

The ROU assets that relate to the 10 stores for which a provision for onerous contracts has been recognised are reduced by an amount equal to the carrying amount of the provision.

The ROU assets that relate to the eight stores for which no provision for onerous contracts has been recognised are not adjusted; no further impairment review needs to be performed for them.

If the entity does not use the practical expedient, it has to apply the guidance in Ind AS 36. It will therefore need to assess whether, on the date of initial application, there is an indicator that an impairment loss has occurred (for example, because the rentals of the sub-lease differ from those of the head lease). If this is the case, the entity will need to calculate the recoverable amount of the ROU asset, in accordance with the guidance in Ind AS 36, and recognise an impairment if necessary. If there is no indicator present, the entity will not have to calculate the recoverable amount.

Contracts for which the entity has not made an assessment based on the guidance in Ind AS 37

For contracts that have not already been assessed, based on the guidance in Ind AS 37 (in this example, 72 contracts), we are of the view that the entity has an accounting policy choice. It can perform an assessment (as described in paras 66 to 69 of Ind AS 37) before its transition to Ind AS 116, and rely on the outcome of the assessment (i.e. adjust the ROU asset by the amount of any provision for onerous contracts). Alternatively, it can apply the guidance in Ind AS 36 in the manner described above.

Please note: The example given above considered retail stores, where each ROU asset is also a cash-generating unit (as defined in Ind AS 36). In a situation where ROU assets are not cash-generating units, an entity needs to still apply Ind AS 36 as normal, to determine when an impairment review is required and what the cash-generating units are.

3. Electing to treat certain lease contracts as short-term leases, when their lease term (as defined in Ind AS 116) ends within 12 months from the initial application date of Ind AS 116.

This practical expedient is independent of the exemption on short-term leases discussed in Section 2 above. The short-term lease exemption (discussed in Section 2) is available if the lease term is 12 months or less from the lease commencement date, whereas this practical expedient is available if the lease term ends within 12 months from the Ind AS 116 initial application date (i.e. 1 April 2019 for March year-end entities). Moreover, the short-term lease exemption (discussed in section 2), if elected, needs to be applied to a class of underlying assets. This practical expedient can be applied on lease-by-lease basis.

A lessee that applies this practical expedient does not recognise an ROU asset and lease liability for leases that have a lease term ending within 12 months from the date of initial application of Ind AS 116.

4. Excluding initial direct costs from measurement of an ROU asset on the date of initial application.
5. Use of hindsight. A lessee is allowed to use hindsight on transition, and the example given in the standard relates to determination of which options (lease extension or termination-related options) are to be included in the lease term. Hindsight can therefore be applied to other judgements such as estimated dismantling costs. In our view, hindsight should not be applied in areas that do not involve judgement or estimation. For example, in the case of a lease where payments vary with the Consumer Price Index (CPI) and a lessee chooses to calculate the right-of-use asset retrospectively, the lessee cannot measure it on the basis of the lease payments as at transition; instead, the lessee should calculate it on the basis of the original lease payments and each inflationary increase.

Key takeaway

Ind AS 116 transition-related choices provide a trade-off between the cost of implementation and the extent of disclosure, and the impact on a lessee's financial statements. A careful analysis is required on the choice of transition approach, as this will not only affect financial statements on the adoption date but also in future years.

(Source: Ind AS 116, Leases notified by the Ministry of Corporate Affairs and PwC's IFRS Manual of Accounting 2019)

Interaction between Ind AS 109, Financial Instruments, and Ind AS 28, Investment in Associates and Joint Ventures

At a glance

Companies (Indian Accounting Standards) Second Amendment Rules, 2019 (the Rules) amended Ind AS 28, Investments in Associates and Joint Ventures. The Rules clarify that Ind AS 109, Financial Instruments, applies to long-term interests in associates or joint ventures. Long-term interests are interests that, in substance, form part of the net investment, but are not accounted for by using equity accounting. In this article, we discuss the amendments to Ind AS 28 and the interaction between Ind AS 109 and Ind AS 28.

Apart from investment in the ordinary shares of associates, investors can have long-term interests (for example, preference shares or long-term loans) in associates, which forms a part of their net investment in the associates (i.e. settlement of which is neither planned nor likely to occur in the foreseeable future). Losses recognised by using the equity method in excess of entities' investment in ordinary shares are applied to such long-term interests in the reverse order of their seniority (i.e. priority in liquidation) as per Ind AS 28.

Ind AS 109 excludes interests in associates and joint ventures accounted for, in accordance with Ind AS 28. However, it was not clear whether this exclusion applies only to interests in associates and joint venture to which the equity method is applied or whether it applies to all interests in associates and joint ventures.

The Rules amend Ind AS 28 to clarify that Ind AS 109-related requirements are applied to long-term interests before applying the loss allocation and impairment requirements of Ind AS 28. An entity should not take account of any adjustments to the carrying amount of long-term interests that result from application of Ind AS 28 when applying requirements pertaining to Ind AS 109.

This amendment to Ind AS 28 is effective from accounting periods beginning on or after 1 April 2019.

Example 1

Nature of interest	Accounting applicability
Equity share investment	Ind AS 28 equity accounting applies (including Ind AS 28 impairment).
Long-term loan, not profit participating but judged to form part of the net investment as not expected to be repaid in the foreseeable future	Ind AS 109 applies to the long-term loan. Ind AS 28 impairment and loss allocation applies to net investment (including the loan).
Short-term loan bearing interest at a market rate or trade receivables	Ind AS 109 applies. Ind AS 28 impairment/ loss allocation does not apply as the short-term loan is not part of the net investment.

Example 2

The investor has the following two types of interests in an associate:

- **Shares:** These are equity shares that represent a 40% ownership interest to which the investor applies the equity method. This interest is the least 'senior' of the interests, based on its relative priority in liquidation.
- **LT loan:** This is a long-term loan that forms a part of the net investment in the associate and which the investor measures at amortised cost by applying Ind AS 109. The LT loan has a stated and effective interest rate of 5% a year. The associate makes interest-only payments to the investor every year. The LT loan is the most senior of the interests.

The amount of the investor's initial investment in equity shares is INR 120 and in the LT loan INR 110.

The table below summarises the carrying amount at the end of every year for an LT loan by applying Ind AS 109, but before applying Ind AS 28 and the associate's profit (loss) for every year:

At the end of	LT loan applying Ind AS 109 (amortised cost)	Associate's profit or loss
Year 1	INR 100	INR 50
Year 2	INR 80	INR 500
Year 3	INR 90	INR 300

Year 1

To recognise initial investment in associate	Dr	Cr
Equity shares	120	
LT loan	110	
Cash		230

To recognise a loss allowance on LT loan (INR 110–INR 100)	Dr	Cr
Profit or loss	10	
Loss allowance (LT loan)		10

To recognise the investor's share of the associate's profit (INR 50 × 40%)	Dr	Cr
Equity shares	20	
Profit or loss		20

At the end of Year 1, the carrying amount of equity shares is INR 140 and the LT loan is INR 100 (net of loss allowance).

Year 2

The investor applies Ind AS 109 to the LT loan before it applies the loss allocation requirements of Ind AS 28.

To recognise the loss allowance (INR 100–INR 80)	Dr	Cr
Profit or loss	20	
Loss allowance (LT loan)		20

To recognise the investor's share of the associate's loss in reverse order of seniority (INR 500 × 40%)	Dr	Cr
Profit or loss	200	
Equity shares		140
LT loan		60

At the end of Year 2, the carrying amount of equity shares is INR 0 and the LT loan (net of loss allowance) is INR 20.

Year 3

Applying Ind AS 109 to its interests in the associate, the investor recognises a decrease in the loss allowance.

To recognise a decrease in the loss allowance (INR 90–INR 80)	Dr	Cr
Loss allowance (LT loan)	10	
Profit or loss		10

To recognise the investor's share of the associate's profit in reverse order of seniority (INR 300 × 40%)	Dr	Cr
LT loan	60	
Equity shares	60	
Profit or loss		120

At the end of Year 3, the carrying amount of equity shares is INR 60 and the LT loan (net of loss allowance) is INR 90.

Key takeaway

The amendment clarifies how Ind AS 109 interacts with Ind AS 28 with respect to an investor's long-term interest in an associate or joint venture. The amendment will assist in eliminating the diversity in practice. Entities with long-term interests in associates or joint ventures need to evaluate the potential impact of the amendment.

(Source: Companies (Indian Accounting Standards) Second Amendment Rules, 2019, issued by MCA and PwC IFRS Manual of Accounting 2019)

Accounting for uncertain tax positions

At a glance

The Rules amended Ind AS 12, Income Taxes, to incorporate Appendix C in Ind AS 12, Uncertainty over Income Tax Treatments (the Appendix). The Appendix clarifies how the recognition- and measurement-related requirements of Ind AS 12 'Income taxes' are applied where there is uncertainty over income tax treatments.

Ind AS 12 (before notification of the Appendix) did not specifically address uncertainties in income taxes, which led to diversity in practice.

The Appendix is applicable to reporters of Ind AS for annual reporting periods beginning on or after 1 April 2019.

This article summaries the key requirements of the Appendix and provides our insights on this.

? What is uncertain tax treatment?

An uncertain tax treatment is any tax treatment applied by an entity where there is uncertainty on whether the treatment will be accepted by the tax authority. For example, a decision to claim a deduction for a specific expense or not to include a specific item of income in a tax return constitutes uncertain tax treatment if its acceptability is uncertain under tax law. The Appendix applies to all aspects of income tax accounting where there is uncertainty regarding the treatment of an item, including taxable profit or loss, the tax bases of assets and liabilities, tax losses and credits, and tax rates.

The Appendix clarifies the following:

? What is the unit of account?

Every uncertain tax treatment is considered separately or together as a group, depending on which approach better predicts the resolution of the uncertainty. The entity considers how it prepares and supports the tax treatment and the approach it expects the taxation authority to take during an examination in order to determine this.

Uncertain tax treatments affect recognition and measurement of tax in the individual financial statements of entities with an uncertain tax position. Such entities need to determine whether they should consider every uncertainty separately or together with other uncertainties (as mentioned above). There will typically be no change in judgements made in the individual financial statements when the same uncertainty is reflected in the parent's consolidated financial statements. However, there may be limited circumstances under which an 'unit of account' in a consolidated financial statement is different from that applied in individuals' financial statements so that a specific uncertainty is considered together with related uncertainties in other entities in the group because that better predicts the resolution of the uncertainty. For example, a tax authority's decision on one transfer pricing matter may affect or be affected by other transfer pricing matters in the same jurisdiction. There may also be situations in which a parent negotiates and settles tax uncertainties of all its subsidiaries in a particular tax jurisdiction collectively. In these situations, uncertain tax treatments may be considered separately in individual financial statements, but for group reporting purposes, similar uncertainties may be grouped together into a single unit of account. The amount recognised on consolidation might not always equal the sum of the amounts recognised in individual financial statements.

? What should an entity assume about examination of tax treatments by the taxation authorities?

An entity should assume that a taxation authority with the right to examine will examine (and have full knowledge of) all relevant information in making those examinations. Therefore, an entity will not be allowed to consider a detection risk in recognition and measurement of uncertain tax treatments.

? When should an entity account for any uncertain tax treatment?

The Appendix requires an entity to consider whether it is probable that a taxation authority will accept an uncertain tax treatment.

An entity might consider a particular tax treatment and conclude that it is probable that the tax authority will accept the proposed tax treatment in the entity's Income-tax filing. So the entity determines its taxable profit, tax losses, tax bases, unused tax losses and/or credits and tax rates consistently with the tax treatment proposed in its filing.

An entity might consider a particular tax treatment and conclude that it is not probable that the tax authority will accept the proposed tax treatment in its income-tax filing. The entity should reflect the effect of the uncertainty in determining its taxable profit, tax losses, tax bases, unused tax losses and/or credits and tax rates by using one of the two methods given below, depending on which method provides the better prediction of the resolution of the uncertainty.

How is the effect of uncertainty recognised?

An entity should measure the impact of the uncertainty by using the method that best predicts the resolution of the uncertainty. The two methods are either (i) the most likely amount (single most likely amount in a range of possible outcomes) or (ii) the expected value (sum of the probability of weighted amounts in a range of possible outcomes). Measurement is not a policy choice.

The most likely amount may better predict resolution of the uncertainty where possible outcomes are binary or are concentrated on a single issue or transaction. The expected value may better predict resolution of the uncertainty where the possible outcomes are widely dispersed.

Consistent judgements and estimates are made for both current and deferred tax where an uncertain tax treatment affects the taxable profit used to determine current tax and tax bases used to determine deferred tax.

What are the implications of changes in circumstances?

The judgements and estimates made to recognise and measure the effect of uncertain tax treatments are reassessed whenever circumstances change or when there is new information that affects the judgements. New information may include action taken by the tax authority, evidence that the tax authority has taken a particular position in connection with a similar item or expiry of the tax authority's right to examine a particular tax treatment. The Appendix specifically states that the absence of any comment from the tax authority is unlikely to be, in isolation, a change in circumstances or new information that would lead to a change in estimates.

Are there any disclosures in the Appendix?

There are no new disclosure-related requirements in the Appendix. However, entities are reminded that they need to disclose, in accordance with Ind AS 1, Presentation of Financial Statements, judgements and estimates made in determining uncertain tax treatment.

Can an entity present liabilities for uncertain tax positions within the scope of the Appendix and Ind AS 12 as 'provisions'?

The Appendix requires an entity to reflect uncertainty over income tax treatments in recognition and measurement of current and deferred tax assets or liabilities, and application of requirements in Ind AS 12. Current and deferred tax liabilities and assets should be presented separately from provisions.

Consequently, an entity should not present current and deferred income tax liabilities in the scope of the Appendix and Ind AS 12 as 'provisions'.

Insight

The Appendix provides a framework to consider, recognise and measure the accounting impact of tax uncertainties. It provides specific guidance in several areas on which Ind AS 12 was previously silent. For example, it specifies how the unit of an account can be determined and the recognition and measurement guidance to be applied to that unit. There is no specific guidance in Ind AS 12, and today, entities may be using different models to determine the unit of an account and measure the consequences of tax uncertainties. The Appendix also elaborates on when accounting for a tax uncertainty needs to be reconsidered, and states specifically that the absence of comment from the tax authority is unlikely, in isolation, to trigger a reassessment.

Most entities will have developed a model to account for tax uncertainties in the absence of specific guidance in Ind AS 12. These models may, in some circumstances, be inconsistent with the Appendix and the impact on tax accounting could be material. Management should assess its existing models against the specific guidance in the Appendix and consider the impact on the entity's income tax accounting.

(Source: Companies (Indian Accounting Standards) Second Amendment Rules, 2019, issued by MCA and PwC IFRS Manual of Accounting 2019)

Ind AS Technical Facilitation Group (ITFG) Clarification Bulletin 19

At a glance

The Ind AS implementation group of the Institute of Chartered Accountants of India (ICAI) constituted the Ind AS Technical Facilitation Group (ITFG) to address issues faced by preparers, users and other stakeholders on applicability and implementation of Ind AS. ITFG issues clarifications in the form of periodic bulletins. These clarifications intend to promote consistency in interpretation and implementation of Ind AS.

The ITFG's recently published Bulletin 19 provides clarification on some of the key issues faced by companies and other stakeholders.

This article provides an overview of the clarifications issued by the ITFG in its Bulletin 19.

1. Retrospective application of Ind AS 110, Consolidated Financial Statements

The requirements of Ind AS 110 apply in respect of consolidation of not only subsidiaries that were acquired by way of business combinations, but also subsidiaries that were formed by the parents and have been the parents' subsidiaries ab initio. Paragraphs 23 and B96 of Ind AS 110 apply to changes in a parent's ownership interest without loss of control of a subsidiary, be it a subsidiary whose control was acquired by the parent in a business combination or one formed by the parent.

Paragraph B7 of Ind AS 101, First-time Adoption of Ind AS, generally prohibits retrospective application of paragraphs 23 and B96 of Ind AS 110 by a first-time adopter. There is nothing in Ind AS 101 to indicate that the prohibition in paragraph B7 on retrospective application of the specified requirements of Ind AS 110 is only applicable in respect of subsidiaries acquired by way of business combinations and not in respect of subsidiaries formed by a parent. Consequently, if a parent entity does not restate its past business combinations, the accounting treatment of purchase of additional interest in a subsidiary carried out by a parent entity in accordance with previous Indian GAAP will continue (i.e. no adjustments will be made) while transitioning to Ind AS.

2. Revenue recognition by a shipping entity in accordance with Ind AS 115, Revenue from Contracts with Customers

A shipping entity should consider the following factors in determining whether its performance- obligation in transferring goods from one port of destination to another is satisfied over time or at a point in time:

a) If another entity is required to transport goods to the port of destination, would it need to substantially re-perform the work carried out by the entity to date? If that work does not need to be substantially re-performed, revenue would be recognised over time.

b) The nature of the performance obligation of the shipping entity does not create an asset with an alternative use. The entity should determine whether it has an enforceable right to payment for its performance completed till date. Determining whether an entity has an enforceable right to payment for its performance completed till date requires consideration of the detailed requirements and guidance provided in paragraphs 37 and B9- B13 of Ind AS 115. These paragraphs, inter alia, require an entity to consider the terms of the contract, as well as any laws that apply to the contract, when evaluating whether it has an enforceable right to payment for its performance completed to date. While the right to payment for performance completed till date does not need to be for a fixed amount, the entity must be entitled at all times throughout the duration of a contract to an amount that at least compensates it for its performance completed till date if the contract is terminated by a customer or another party for reasons other than the entity's failure to perform as promised.

3. **Application of simplified transition method in Ind AS 115 to a first-time adopter of Ind AS**

   A first-time adopter of Ind AS is allowed to only apply the 'full retrospective adoption' method (with certain practical expedients), as provided in Ind AS 115. A first-time adopter of Ind AS does not have the choice of applying the simplified transition method.

4. **Capitalisation of borrowing costs subsequent to a business combination**

   Subsequent to a merger, an acquirer should make a fresh and independent assessment about whether an item of capital work-in-progress (CWIP) meets the definition of a 'qualifying asset' from its perspective. In determining whether CWIP meets the definition of a 'qualifying asset', the acquirer should only consider the remaining time for completion of the asset from the date of the merger.

   The same considerations would be equally applicable in the consolidated financial statements of an acquirer wherein the acquirer acquires 100% shares of an 'acquiree', which remains a separate legal entity and the acquirer's consolidated financial statements include CWIP as an asset.

5. **Applicability of 'pooling of interests method' to transfer of a business division**

   Transfer of a division (which meets the definition of a 'a business' under Ind AS 103) from a parent to its subsidiary as per an approved scheme qualifies as a common control business combination in accordance with Appendix C to Ind AS 103, 'Business combination of entities under common control'. Accordingly, the transferee should account for transfer of a division in its financial statements by applying the pooling of interests method. In accordance with the pooling of interests method, comparative financial information in the financial statements of the transferee should be restated as if the transfer of the division occurred from the beginning of the comparative period presented, notwithstanding the appointed date mentioned in the Scheme.

6. **Applicability of Ind AS subsequent to a business combination**

   An entity should continue to follow Ind AS even if it subsequently does not meet either the net worth or the listing criterion laid down in the Companies (Indian Accounting Standards) Rules, 2015 or is no longer a subsidiary or a holding company, or an associate or joint venture of a company meeting the listing or net worth criterion.

In brief

Clarifications by ITFG are useful for entities and other stakeholders in application of Ind AS. Entities should carefully evaluate the clarifications issued by the ITFG and exercise their judgement while applying these to their specific circumstances.

Source: ICAI's Ind AS Technical Facilitation Group Bulletin 19)

Institute of Chartered Accountants of India (ICAI)

Expert Advisory Committee's (EAC's) opinions

(i) Accounting treatment of expenditure relating to onerous contracts

The querist has sought the opinion of the EAC on accounting treatment of expenditure relating to onerous contracts. Ind AS 37 defines an onerous contract as "a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it".

The EAC noted that Ind AS 37 provides that the amount recognised as a provision shall be the best estimate of the expenditure required to settle a present obligation, which is the amount an entity would rationally pay to settle the obligation at the end of the reporting period or transfer it to a third party at that time. The EAC was of the view that in the case of onerous contracts, the amount an entity would rationally pay to settle an obligation would be the lower of the compensation or penalties arising from its failure to fulfil the contract and the excess of the unavoidable costs of meeting the obligations under the contract from the economic benefits expected to be received under it. Accordingly, the provision for onerous contract should be measured on the principles given above.

The EAC noted that paragraph 68 of Ind AS 37 uses the expression "unavoidable costs of the meeting the obligations under the contract". The Committee was of the view that the expression 'unavoidable costs' means the costs that cannot be avoided due to the existence of a contract. These are costs that directly relate to a contract, for example, direct labour, direct material and allocation of costs that relate directly to contract activities. In context of the current issue, the Committee noted that the entity had not considered its administrative overheads, finance charges, R&D expenses, sales overheads and its headquarter's expenditure while creating provision for an onerous contract. The Committee was of the opinion that generally such costs do not relate directly to a contract, and therefore, should not be considered while creating a provision for an onerous contract.

Furthermore, since Ind AS 37 requires provision of all the costs to fulfil obligations under a contract, the Committee was of the view that in a contract to supply a product, the costs should include all expenditure till supply of the product including the cost of supplying the product.

(ii) Presentation of deferred tax recoverable from beneficiaries (customers) accounted as 'Deferred Asset for Deferred Tax Liability'

An entity is engaged in construction of hydropower projects and operates these on a build, own, operate and maintain (BOOM) basis. With electricity, being a regulated product, the tariff for every power station is determined by the Central Electricity Regulatory Commission (CERC), based on the CERC Tariff Regulations issued for a period of five years at a time. The currently applicable tariff period is 2014-15 to 2018-19, i.e. 2014-19.

The tariff norms for the period 2014-2019 notified by the CERC provide for grossing up of the return on equity with the effective tax rate of the financial year, based on the actual tax paid during the year on income from generation of power. Accordingly, deferred tax provided during the year on income from generation and recoverable from beneficiaries in future periods is accounted for as 'Deferred tax adjustment against Deferred Tax Liability'. The 'Deferred tax adjustment against Deferred Tax Liability' so created for the year is netted off from the "'Deferred Tax expense' in the profit and loss account and from the deferred tax liability in the balance sheet. The asset so created during the tariff period 2014-19 will be reversed in future years (including the tax holiday period) when the related deferred tax liability forms a part of the current tax and is recoverable from beneficiaries by way of grossing up of the Return on Equity.

The entity has applied Ind AS from 1 April 2015 and opted to apply Ind AS 114, Regulatory Deferral Accounts, in its first Ind AS financial statements. The querist sought the opinion of the EAC on whether presentation of a regulatory deferral asset on the deferred tax liability balance, recognised as per the requirements of Ind AS 114, is appropriate and in line with the requirements of Ind AS.

The EAC was of the opinion that the 'Deferred tax adjustment against Deferred Tax Liability' is in the nature of regulatory deferral account balance under Ind AS 114 and not a deferred tax asset. Presentation of the entity's deferred tax liabilities balance in its balance sheet and deferred tax expense in its statement of profit and loss, each net of 'Deferred tax adjustment against Deferred Tax Liability' is not in compliance with the requirements of Ind AS 114 and Ind AS 12.

Financial Reporting Review Board (FRRB)

The FRRB reviews the general purpose financial statements (GPFS) of enterprises with the view to identify any non-compliance with accounting and auditing standards, Companies Auditor's Report Order (CARO), the Companies Act and other statutory requirements applicable for preparation and presentation of financial statements. The non-compliance observed by the FRRB in implementation of AS 3, Cash Flow Statement; AS 18, Related Party Disclosures; and AS 2, Valuation of Inventories; was published in recent ICAI journals.

Among other matters, the FRRB's observations included:

- **AS 2:** Incorrect disclosure of valuation of inventories, non-consideration of Excise Duty in valuation of inventories and incorrect disclosure of the cost formula of inventories
- **AS 3:** Non-adjustment of unrealised foreign exchange gain or loss in cash flow statement, interest expense reported net in cash flow statement, disclosure of corporate Dividend Distribution Tax under cash flow from operating activities instead of cash flow from financing activities
- **AS 18:** Non-disclosure of description of relationship with related parties and incorrect identification of key managerial personnel

For detailed FRRB observations, refer https://resource.cdn.icai.org/55377cajournal-june19-29.pdf and https://resource.cdn.icai.org/55116cajournal-may19-30.pdf

Accounting Standards Board (ASB)

The ASB of ICAI has released an updated e-version of Ind AS compendium, which encompasses Ind AS (issued by the MCA) and is mandatory for accounting periods beginning on or after 1 April 2019. Refer https://www.icai.org/post.html?post_id=15365

FAQs on Banning of Unregulated Deposit Schemes Ordinance, 2019

The ICAI's Committee on Economic, Commercial Laws and Economic Advisory has released a publication, FAQs on Banning of Unregulated Deposit Schemes Ordinance, 2019.
Refer https://resource.cdn.icai.org/55285faqbudicai.pdf

Ministry of Corporate Affairs (MCA)

Companies (Prospectus and Allotment of Securities) Third Amendment Rules, 2019

The MCA has notified the Companies (Prospectus and Allotment of Securities) Third Amendment Rules, 2019. The rules require every unlisted public company governed by it to submit Form PAS-6 to the Registrar within 60 days of the conclusion of each half year (duly certified by a company secretary in practice or a chartered accountant in practice). Form PAS-6 specifies the 'Reconciliation of the Share Capital Audit report' on a half-yearly basis. A company should immediately bring to the notice of the depositories any difference observed in its issued capital and its capital held in a dematerialised form. The amendment rules will be effective from 30 September 2019.

Companies (Acceptance of Deposits) Second Amendment Rules, 2019

The MCA, vide its notification dated 30 April 2019, has amended the Companies (Acceptance of Deposits) Rules, 2014. This amendment is in relation to its earlier notification dated 22 January 2019, which mandated that non-government companies should file Form DPT 3, providing particulars of transactions that were not considered as deposits as on 22 January 2019. As per the amendment rules, companies are required to provide the information mentioned above as on 31 March 2019. Furthermore, the due date for filing Form DPT 3 was extended from 22 April 2019 to 30 June 2019.

Amendment to Schedule VII of the Companies Act, 2013

The MCA has amended Schedule VII of the Companies Act, 2013 to add, disaster management, along with relief, rehabilitation and reconstruction activities, to the list of permitted activities that qualify as Corporate Social Responsibility (CSR) activities.

Central Board for Direct Taxes (CBDT)

Form 3CD (Tax Audit) reporting

The CBDT, vide its order dated 14 May 2019, deferred the requirement for companies to include in their tax audit reports the details of the Goods and Services Tax (clause 30C) and General Anti-Avoidance Rules (Clause 44). Reporting requirements under clause 30C and Clause 44 have been kept in abeyance till 31 March 2020.

Reserve Bank of India (RBI)

Reserve Bank of India (Prudential Framework for Resolution of Stressed Assets) Directions 2019

The RBI has issued the Reserve Bank of India (Prudential Framework for Resolution of Stressed Assets) Directions 2019. These directions were issued with a view to provide a framework for early recognition, reporting and time-bound resolution of stressed assets.

The provisions of these directions will apply to the following entities:

- Scheduled Commercial Banks (excluding Regional Rural Banks)
- All India Term Financial Institutions (NABARD, NHB, EXIM Bank, and SIDBI)
- Small Finance Banks
- Systemically Important Non-Deposit-taking Non-Banking Financial Companies (NBFC-ND-SI) and Deposit-taking Non-Banking Financial Companies (NBFC-D)

Insurance Regulatory and Development Authority of India (IRDAI)

Preparation of Financial statements for FY2019-20 and onwards

The IRDAI has issued a circular, dated 20 May 2019, to provide directions in order to bring uniformity in comparability and fair presentation of financial statements filed by insurers. In addition to other directions, the circular provides its directives on presentation of the excess expenses of management (EoM) in operating expenses, personal accident policies in the health segment, deviation from prescribed formats, the creation of unearned premium reserves and outstanding claims reserves for premiums ceded under clean-cut reinsurance treaties and segregation of policyholders' and shareholders' funds.

Preparation of Solvency Statement for FY2019-20 and onwards

During its perusal of the solvency returns filed, the IRDAI observed that certain assets, though "unrealisable in nature", are considered at book value for the purpose of computation of available solvency margins. Similarly, it was observed that a few sub-segments, instead of being clubbed with their respective segments, have been included under the 'Miscellaneous segment' while computing the required solvency margin. In order to have uniformity, consistency and comparability, the IDRAI issued a circular on 20 May 2019, providing directions for preparation of solvency statements.

Financial Accounting Standards Board (US GAAP)

Targeted transitional relief for the new credit loss standard

On 15 May 2019, the FASB issued ASU 2019-05, Financial Instruments—Credit Losses (Topic 326): Targeted Transition Relief (the ASU). The ASU amends the transition-related guidance in the new credit losses standard, ASC 326, Financial Instruments—Credit Losses.

The amendment provides entities with an option, on their adoption of ASC 326-20, to irrevocably elect a fair value option for certain financial instruments that are both within the scope of ASC 326-20 (the current expected credit loss or 'CECL' model) and are eligible for the fair value option in ASC 825-10, Financial Instruments—Overall. This election should be applied on an instrument-by-instrument basis for eligible financial assets.

This fair value option election is not applicable to debt securities classified as 'available for sale or held to maturity'. In addition, the amendment does not provide the option to discontinue or "unelect" the fair value option on instruments when an entity previously elected to apply it.

If the fair value option is elected, an entity will recognise the difference between the carrying amount and the fair value of the financial instrument as a part of the cumulative effect adjustment associated with adoption of ASC 326. Subsequently, the financial instrument will be measured at fair value with changes in its fair value reported in its current earnings.

Under the current guidance, the fair value option can only be elected for eligible instruments on specified election dates (for example, when an entity first recognises a financial asset). This amendment allows entities to opt for the fair value option for existing eligible instruments on its adoption of the new credit losses standard.

ASC 326-20 does not apply to financial assets that are measured at their fair value through net income, so the CECL model would not be applied to financial assets to which an entity elects to apply the fair value option.

ASU 2019-05 is effective, concurrent with adoption of the new credit losses standard. For entities that have already adopted the new standard, the ASU is effective for calendar year-end entities on 1 January 2020, but early adoption is permitted.

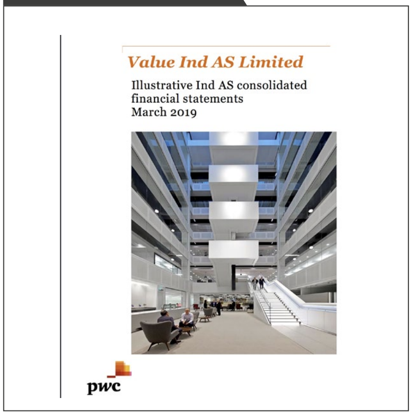
(Source: ICAI EAC opinions and FRRB observations, notifications/circulars issued by RBI, IRDAI and CBDT and FASB ASU)

Previous publications

Publications-1

Publications-2

Publications-3



Publications-4

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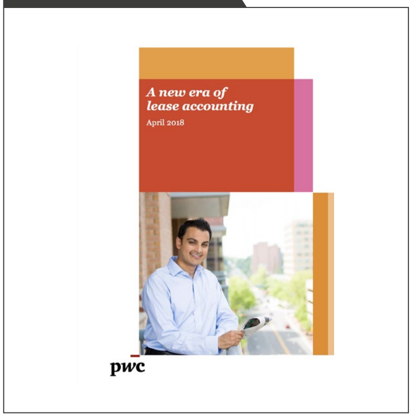

Publications-7

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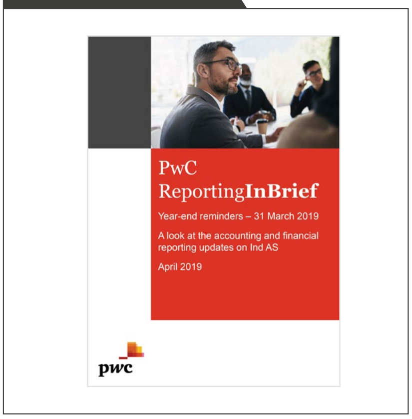

Publications-9

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Data Classification: DC0

PD/July2019-18419