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PwC ReportingPerspectives

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We are pleased to bring you our quarterly newsletter covering the latest developments in financial reporting as well as other regulatory updates.

The ICAI has been issuing guidance in new areas relating to the Companies Act, 2013, which has both accounting and auditing implications. In this edition, we have analysed key matters covered in the guidance note on accounting for expenditure on corporate social responsibility activities, which is effective from 15 May 2015.

Another major regulatory development for India is the issuance of Income Computation and Disclosure Standards (ICDS) by the tax authorities. These are applicable for the financial year ending 31 March 2016 and are significantly different from the existing accounting standards. Entities will be required to apply the ICDS in computing their taxable income and tax liabilities effectively immediately, especially due to the advance tax requirements. We discuss some important implications.

One area that has both companies as well as boards concerned is how one can ensure compliance with the requirements of board evaluation, thereby further strengthening corporate governance. The article on this topic attempts to capture some salient features related to this new requirement.

This edition also informs you of the key provisions of the new Accounting Standard Update 2015-03: Simplifying the Presentation of Debt Issuance Costs and Accounting Standards Update 2015-04: Compensation—Retirement Benefits, under US GAAP issued by the FASB recently.

With the first phase of companies having to apply Ind AS for the period beginning 1 April 2016, together with comparative Ind AS information for the period 1 April 2015 to 31 March 2016, there is little any time left for implementation. One of the first Ind AS standards that a company will need to apply and which is likely to have a considerable impact is Ind AS 101. This is very important as it will shape the company's Ind AS accounts going forward. We have provided an overview of this standard, the optional accounting policy choices available, mandatory exceptions in the standard and the significant carve outs from IFRS, as issued by the IASB.

We have also discussed other Indian as well as global regulatory updates, including the proposed plans for deferral of the new revenue standard under IFRS and US GAAP as well as consequential implications of Ind AS.

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CSR: An accounting perspective

Corporate Social Responsibility (CSR) has been one the most debated topics in the Companies Act, 2013 (the 2013 Act). From the tax implications of CSR to the very need to legislate social responsibility have seen arguments from those in favour of and those against it. But CSR is now a reality, even though it is not mandatory but rather comes with a 'comply or explain' approach.

Section 135 of the 2013 Act which deals with CSR and the Companies (Corporate Social Responsibility Policy) Rules, 2014 (CSR Rules) have been applicable from 1 April 2014.

The 2013 Act requires all companies which meet the specified criteria (net worth, turnover or profit) to constitute a CSR committee which is required to formulate and recommend the CSR policy and the quantum of expenditure to the board. It is also required to periodically monitor the firm's CSR policy.

The board's responsibilities include approving the CSR policy, disclosing it in the board's report and the company's portal, if any, and ensuring that activities included in the CSR policy are actually undertaken. Further, the 'comply or explain' approach adopted by the 2013 Act requires that where the company has not been able to spend the requisite amount (2% of the average net profits of the company during the three immediately preceding years) during the year, such inability to spend will need to be disclosed in the board's report along with the reasons.

While the Ministry of Corporate Affairs has been issuing circulars and amendments to ensure that the law is implemented easily, there were several questions about accounting for CSR activities. The Corporate Laws and Corporate Governance Committee of ICAI had initially issued frequently asked questions (FAQs) about CSR in March 2015 which addressed a few concerns. Subsequently, however, the ICAI has issued the Guidance Note on Accounting for Expenditure on Corporate Social Responsibility Activities (Guidance Note) which is effective from 15 May 2015. It states that the FAQs issued earlier which related to areas covered by the Guidance Note are now withdrawn. It is essential to understand that while the Guidance Note is an authoritative guidance (auditors are required to ensure compliance with Guidance Notes), the FAQs have no authoritative status and some companies opted not to follow the requirements of the FAQs until the Guidance Note was issued.

CSR applicability criteria: CSR requirements are applicable to any company having:

- *Net worth of 500 crore INR or more, or*
- *Turnover of 1000 crore INR or more, or*
- *Net profit of 5 crore INR or more during any of the three preceding financial years*

Provision for unspent amounts: To recognise provision or not

There were divergent views with respect to accounting for the unspent amount (any shortfall in the amount to be spent as required under section 135). However, the FAQs and now the Guidance Note have made it clear that provisions should not be recognised for any unspent amounts. But if a company has already undertaken certain CSR activity for which a liability has been incurred by entering into a contractual obligation, then in accordance with the generally accepted principles of accounting, a provision for the amount representing the extent to which the CSR activity was completed during the year needs to be recognised in the financial statements. The Guidance Note in fact defines 'spend:' "The term 'spend' in accounting parlance generally means the liabilities incurred during the relevant accounting period".

There was also an issue in terms of where the company spends more than the required amounts, did the company have an option to carry such amounts forward to set off against the CSR expenditure required to be spent in future. The Guidance Note addresses this by referring back to the 2013 Act, where section 135(5) states that the prescribed amount is the minimum to be spent. Consequently, the question of carrying forward the excess spend of one year to the next does not arise.

Recognising various CSR expenditure

Accounting and recognition are straightforward for contributions to the three funds (Prime Minister's Relief Fund, Swachh Bharat Kosh and Clean Ganga Fund) currently notified under the 2013 Act: they are to be recognised in the statement of profit and loss, when contributed.

Additionally, companies have the option of engaging with a registered trust or society, or a company established under section 8 of the 2013 Act in order to undertake CSR activities. In such cases, the Guidance Note requires companies to treat any contributions to such entities as expense for the year by charging them to the statement of profit and loss.

In such cases, the company also needs to specify the projects or programmes to be undertaken, modalities for using funds as well as monitoring and reporting. This seems to indicate that the company's responsibility does not end with making contributions to these entities. Rather, these entities are merely the mode in which the projects are undertaken and the company continues to be responsible for the projects as if they were being run by it.

This leads one to ask whether the company should be recognising contributions to the trust in the same manner as it would if it were to have incurred them on its own, rather than recognising contributions as expenditure as and when they are given to such entities. While some companies believe that on account of CSR Rule 7, any contribution should be considered as CSR expenditure (irrespective of whether it is spent by the trust in the same year or not),

others think that since Rule 7 relates only to contributions to the corpus, all other contributions should be recognised as CSR expenditure only when they are incurred.

The third model is where the company engages in CSR activities on its own. In these cases, the Guidance Note requires the expenditure to be analysed in terms of whether it is revenue or capital in nature. While revenue expenditure is required to be recognised in the statement of profit and loss as and when incurred, the Guidance Note requires further evaluation of capital expenditure. It refers back to the definition of 'asset' as per the Framework for Preparation and Presentation of Financial Statements, and suggests that where the company has no control over the asset (for instance, where a school is constructed and handed over to the local authorities), such expenditure needs to be charged to the statement of profit and loss as and when incurred. However, where the company retains control of the asset, it needs to be examined whether any future economic benefits accrue to the company. The Guidance Note does not provide a conclusive response and ends by stating that, invariably, future economic benefits from a CSR asset will not flow to the company, as any surplus from CSR cannot be included in business profits under Rule 6(2) of the CSR Rules.

However, there can be circumstances where control over an asset is retained by the company and the asset is used by the public as well as employees and their families, or partially used for CSR and partially run as a commercial enterprise. The Guidance Note does not discuss the accounting implications in such cases.

For situations where the company's current assets (for instance, inventory) are used for CSR activities, the Guidance Note lays down that asset valuation needs to be in accordance with the requirements of AS 2: Valuation of Inventories, to determine the CSR expenditure.

Lastly, where the company receives a grant from others for carrying out CSR activities, the Guidance Note requires such expenditure to be measured net of the grant.

Income earned from CSR activities

CSR Rule 6 (2) states that "the surplus arising out of the CSR projects or programs or activities shall not form part of the business profit of a company". However, since any item of income or expense needs to be included while determining net profit or loss for the period (as per AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies), the Guidance Note requires any surplus from CSR activities to be recognised in the statement of profit and loss. However, to comply with legal restrictions, it should immediately be recognised as liability for CSR expenditure in the balance sheet and with a corresponding charge to the statement of profit and loss. Further, such surplus should not form part of the minimum 2% of the average net profits made during the three immediately preceding financial years for determining the applicability/spend in future.

Presentation and disclosure

Schedule III to the 2013 Act, which prescribes the form and content of financial statements, requires a separate disclosure of the amount incurred towards CSR in the statement of profit and loss. However, the Guidance Note requires further disclosures, which include the amount required to be spent by the company under the 2013 Act, a break-up of the expenses incurred together with details of various heads of expenses and the fact whether they have been or are yet to be paid in cash.

It also identifies other accounting standards, where disclosures relating to CSR may be required. For instance, where the trust, society or section 8 company through which the firm undertakes CSR activities is a related party, disclosures under AS 18: Related Party Disclosures are to be made. Further, where a provision is made towards CSR activities, the Guidance Note requires disclosure to be made as per Schedule III, including disclosure of the movements in the provisions.

It is relevant to note that the Guidance Note, while talking about provisions for CSR expenditure, refers to any accrual of expenses as liability.

The disclosure requirement for movement in provision is relevant to provisions as per AS 29: Provisions, Contingent Liabilities and Contingent Assets and not relevant to liabilities. However, given the status of the Guidance Note, the movement should be included as an additional disclosure in financial statements.

Conclusion

The 2013 Act is constantly evolving, with circulars, notifications and amendments coming through continuously. The ICAI has had to respond to these changes with its own guidance for accountants and auditors. The Guidance Note is a welcome step as it helps with implementation issues arising from accounting for CSR activities.

ICDS: Are these meeting the intended objective?

Background

The Central Board of Direct Taxes (CBDT) has notified 10 standards referred to as Income Computation and Disclosure Standards (ICDS) using the provisions of section 145(2) of the Income Tax Act, 1961 (the 'Act'). These standards will be applicable for the computation of income chargeable under the head 'profit and gains of business or profession' or 'income from other sources' and are effective from the assessment year 2016-17 —the assessees will need to consider these tax standards for the purpose of computing advance tax from the first quarter of the financial year ending 31 March, 2016.

Considering that the ICDS are different from the accounting standards used in the preparation of financial statements, assessees will need to evaluate the extent of adjustments required in all areas covered by the ICDS. These areas include revenue recognition (including construction contracts), valuation of inventory, borrowing costs, treatment of foreign exchange differences, cost of tangible assets and others. Apart from specifying the requirements with respect to recognition and measurement, the ICDS also include certain disclosure requirements. The ICDS clearly state that they are not meant for the purpose of maintenance of books of accounts.

Areas covered by ICDS

ICDS I: Accounting policies
ICDS II: Valuation of inventories
ICDS III: Construction contracts
ICDS IV: Revenue recognition
ICDS V: Tangible fixed assets
ICDS VI: Effects of changes in foreign exchange rates
ICDS VII: Government grants
ICDS VIII: Securities
ICDS IX: Borrowing costs
ICDS X: Provisions, contingent liabilities and contingent assets

Differences with accounting standards

ICDS I, Accounting Policies, does not recognise the concepts of materiality and prudence, which are the primary considerations in the selection of accounting policies by an enterprise under Accounting Standard (AS) 1—Disclosure of Accounting Policies. While this may suit the tax authorities, it is likely to have a significant impact on revenue recognition (resulting in early recognition in certain cases) and deferring recognition of certain expenses/expected losses (e.g. mark to market adjustments). This in turn will have an impact on the timing and amount of the tax outflows of entities.

Specifically, with respect to revenue recognition, the ICDS does not permit the completed service contract method and requires all service contracts to be recognised on the basis of percentage of completion method (applicable for construction contracts). Further, vis-à-vis Accounting Standard 7, Construction Contracts (AS 7), ICDS III—Construction Contracts—prohibits deduction of future anticipated losses on onerous contracts. Also, it prescribes a 25% stage of completion, which has to be achieved before recognising the margins under the construction contracts. Until such time, revenue is recognised as equal to costs incurred. This is different from the principles in AS 7, which require the margin to be recognised as soon as the outcome of the contract can be reliably estimated; there are no bright lines. The ICDS does not require the contract to advance significantly for the purpose of determining the probability for recognition of incentives and claims as part of revenue.

ICDS IX relating to borrowing costs is also likely to bring in significant changes for assessees. To begin with, ICDS does not specify 'substantial period' as a marker for identifying the qualifying assets except in case of inventories. Further, borrowing costs do not include exchange differences arising on foreign currency borrowings. The standard is likely to advance the commencement of capitalisation of borrowing costs (e.g. from the date of receiving funds in case of specific borrowings). The ICDS now provides a new formula for capitalising the borrowing cost where funds are borrowed in general and used for acquiring or constructing an asset. The formula will allocate the borrowing costs incurred during the year (except on specific borrowings) in the ratio of the average of costs of qualifying asset as appearing in the balance sheet on the first day and the last day of the year to the average of the amount of the total assets as appearing in the balance sheet on the first day and the last day of the year. It also specifies that borrowings cost can be capitalised even when active development is interrupted, which is not permissible under Accounting Standard 16, Borrowing Costs (AS 16). AS 16 requires income from temporary deployment of funds to be reduced from the borrowing costs eligible for capitalisation, however, in absence of any specific requirement under the ICDS, income arising from temporary deployment of funds will be treated as 'income'. All of this will require additional computation and calculations efforts, including documentation.

ICDS VI, Effects of Changes in Foreign Exchange Rates (ICDS VI), requires foreign exchange rate differences with respect to assets to be recognised in accordance with section 43A of the Act and Rule 115 of the Income Tax Rules, 1962. The section contains special provisions relating to changes in the rate of exchange of currency and provides payment as the basis for making adjustments to the actual cost of fixed assets acquired from a country outside India. Effective from 1 April 2003, the Finance Act, 2002, settled the controversy on the basis (payment or accrual) to be used for adjusting foreign exchange rate changes during any year

after the acquisition of such asset, which has the effect of increasing or reducing the foreign currency liability expressed in Indian currency. However, the adjustment to the cost of fixed assets on account of foreign exchange differences under the ICDS differs from the Accounting Standard 11, The Effects of Changes in Foreign Exchange Rates (AS 11), which provides accrual as the basis for making adjustments to the cost of depreciable assets (where an entity has opted to follow the alternative of capitalising exchange difference on long-term monetary item instead of recognising it in the statement of profit and loss).

ICDS VI includes foreign currency option contract or another financial instrument of a similar nature within the definition of forward exchange contract (FEC). The recognition and measurement principles of AS 11 continue to apply for FECs not intended for trading or speculation purposes under ICDS, i.e. any premium or discount arising at the inception of a FEC shall be amortised as expense or income over the life of the contract and exchange differences on such a contract shall be recognised as income or as expense in the year in which the exchange rates change. However, ICDS provisions significantly differ in respect of forward exchange contracts held for trading or speculation purpose, firm commitments and highly probable forecast transactions. In such cases, ICDS requires the premium, discount or exchange difference to be recognised only at the time of settlement, unlike the current accounting standards.

Another significant difference between AS 11 and ICDS VI relates to accounting for the exchange differences of 'non-integral operations'. ICDS requires monetary and non-monetary items relating to a non-integral foreign branch to be restated each year end and the resulting exchange differences to be recognised in a statement of profit and loss. While AS 11 also requires restatement of both monetary and non-monetary items as at each reporting date, however, the resulting exchange differences are recorded in a reserve.

Tax treatment of government grants may change under ICDS. As per ICDS VII, Government Grants, recognition of grants should not be postponed beyond the date of its actual receipt and does not require any assessment of likely fulfilment of conditions attached to the grant, which is otherwise required under AS 12 for accounting purposes. In line with the change in the definition of the term 'income' under section 2(24) by the Finance Act, 2015, (which now includes any assistance in the form of subsidy, grant, etc provided by the government or any authority in cash or in kind to an assessee), the ICDS does not allow recognition of grants in the nature of the promoter's contribution directly in the reserves.

In certain cases, the ICDS deal with a topic only partially, such as in the case of investments. ICDS VIII on securities covers only those securities which are held as stock in trade. This ICDS requires assessment of cost and net realisable value to be performed category wise as compared to AS 13 which states that the more prudent and appropriate method is to carry investments individually at the lower of cost and fair value.

Reduction in litigations?

While amendments in the law are made with the intent of reducing litigations, it remains to be seen whether notification of these ICDS will achieve this objective. The preamble to ICDS envisages and mentions that in case of possible conflicts between ICDS and the Income Tax Act, the provisions of the Act will continue to prevail. An important aspect for consideration is the judicial decisions of the Supreme Court on various tax matters, including interpretations of tax law. There can be circumstances where ICDS provides guidance on a matter which may be in conflict with previous judicial precedents. The question to ask is whether this will really reduce or increase tax litigations?

Conclusion

ICDS are not accounting standards based on the generally accepted accounting principles (GAAP); rather they prescribe the manner of computing taxable income. Further, as clarified in the preamble, ICDS are not for the purpose of maintaining books of accounts.

Entities will need to take a closer look at the details of these standards to evaluate its implications on their tax positions and liabilities fairly quickly as ICDS is applicable for this year ending 31 March, 2016.

Board evaluation: Towards improved governance

Background

It is common for companies to appraise their officers, employees, business units, business partners and vendors. It is not common, however, to see directors, the most significant contributors in a corporate, being subjected to a formal appraisal or evaluation. While the phenomenon is nascent in India, even globally, it can best be described as recent and evolving.

One key theme that emerges from the new company law is greater accountability, responsibility and liability of directors. The idea is to make the board more accountable to shareholders, who are the ultimate owners of the company. Evaluation of the board's performance is a significant step towards increased accountability and transparency, given that the board wields significant authority and is trusted to act in the best interest of shareholders.

Need for evaluation

An effective board ensures that the interests of shareholders are at the heart of the board that it is elected to represent. Over time, a board may need new skills and perspective to respond swiftly and appropriately to changes in the business environment or strategy. Regular and rigorous self-evaluations help it to assess its performance as well as identify and address potential areas for improvement.

Boards are very complex structures confronted with formidable challenges. The fast-changing business environment means that directors may not always be able to rely on experience alone. Oversight coupled with foresight can add considerable value to growth and success.

In jurisdictions where board evaluation is prevalent, shareholders value the detailed disclosure while making voting decisions about directors. Disclosures about how the board evaluates itself, identifies areas for improvement and addresses them, provide an insight on how robust the board and its functioning is.

Regulatory framework in India

Board evaluation, a voluntary initiative until recently, was considered as a good corporate governance practice. The pre-revised Clause 49 of the Equity Listing Agreement provided for performance evaluation of the non-executive directors as a non-mandatory requirement.

The Companies Act, 2013 mandates a formal annual evaluation of the board, its committees and individual directors. It follows the approach of UK's corporate governance code in terms of disclosure.

Disclosure in board's report

In case of a listed company and every other public company having paid-up share capital of 25 crore INR or more, a statement indicating the manner in which formal annual evaluation has been made by the board, of its own performance and that of its committees and individual directors, has to be made in the board's report.

Role of the nomination and remuneration committee (NRC)

The NRC has been entrusted with the responsibility of identifying persons who are qualified to become directors and who may be appointed to the senior management in accordance with the criteria laid down, recommending to the board their appointment as well as removal, and evaluating every director's performance.

Role of independent directors

The code of conduct of independent directors as given in Schedule IV of the Companies Act, 2013, casts upon the independent directors a duty to review the performance of the non-independent directors, the chairperson and board as a whole. They play an important role and are expected to bring objectivity as well as an independent perspective to the whole process.

Role of the board

The board has an important role to play in setting up the entire framework and ensuring its effectiveness. Apart from conducting an evaluation under the Companies Act, 2013, the board has to also monitor and review the board evaluation framework under Clause 49 of the listing agreement.

Who has to be evaluated and by whom?

The NRC has to facilitate the entire review and evaluation exercise. Internationally, the following three modes are used:

- Internal evaluation
- External evaluation
- Internal evaluation facilitated by an external agency

In the UK and some other mature jurisdictions, external evaluation is conducted once in three years. It is of utmost importance to develop trust and credibility around the process of evaluation, irrespective of the mode being used.

Appraisee	Appraiser
The board of directors	Review by independent directors and self-assessment by the board
Independent directors	Evaluation by the NRC as well as the board
Non-independent directors	*Evaluation by the NRC as well as the board* Review by independent directors
Chairperson	*Review by the independent directors* Evaluation by the board as well as the NRC
Board committees	Evaluation by the board

Evaluating results

- The very purpose behind the introduction of performance evaluation is to provide an opportunity for constructive feedback and meaningful introspection. Globally, the trend is to disclose the mechanism for evaluation along with emerging trends, in the annual report. The individual results are not shared with the stakeholders. It is thus important that the entire exercise is done is a transparent yet confidential manner. Global surveys indicate that the evaluation results are used for:
- Identification of any skill or diversity gap in the board
- Providing feedback to individual directors
- Providing inputs on the board's processes
- Identifying improvement opportunities

There is no uniform best practice which can be prescribed; the maturity of the board and individual directors will determine how the evaluation outcome is dealt with in the best way possible. The role of the chairman becomes vital as it is up to him or her to drive performance culture as well as derive maximum benefits out of this exercise.

Key challenges

The process may encounter initial hurdles such as reluctance in sharing fair views, difficulty in ensuring transparency and building trust. Given the confidentiality and sensitivity associated, corporates are treading with caution in the first year and taking measured steps to comply with the law. However, perhaps in another two to three years, when the process and concept have matured, a more robust approach may evolve.

Way forward

The philosophy behind performance evaluation is to help the board optimise its performance, which in turn, should propel the overall growth of the organisation. The government has given corporates the flexibility to choose the evaluation modes, tools and techniques that suit them best. India Inc should make the most of this opportunity by not treating it as a mere compliance exercise. One hopes that the entire process will be used constructively as a developmental tool to bolster the governance quotient.

Simplifying the presentation of debt issuance costs

Background

Debt issuance costs are specific incremental costs, other than those paid to the lender, that are directly attributable to issuing a debt instrument (i.e. third-party costs). Before the new standard was issued, debt issuance costs had to be presented in the balance sheets as a deferred charge (i.e. an asset).

What's new?

On 7 April 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update 2015-03, Simplifying the Presentation of Debt Issuance Costs, which requires debt issuance costs to be presented in the balance sheet as a direct deduction from the carrying value of the associated debt liability, consistent with the presentation of a debt discount.

Rationale

The FASB has issued this update as part of its Simplification Initiative to reduce complexity in accounting standards. The initiative aims to identify, evaluate and improve areas of generally accepted accounting principles (GAAP) for which cost and complexity can be reduced while maintaining or improving the usefulness of information given to users of financial statements.

Presentation of debt issuance costs as a deferred charge (i.e. an asset) differed from that of a debt discount, which is a direct adjustment to the carrying value of the debt (i.e. a contra liability). Having different balance-sheet presentation requirements created unnecessary complexity.

This presentation also differed from the guidance in International Financial Reporting Standards (IFRS), which requires that transaction costs be deducted from the carrying value of the financial liability and not recorded as separate assets. Additionally, the requirement to recognise debt issuance costs as deferred charges conflicts with the guidance in FASB Concepts Statement No 6: Elements of Financial Statements, which states that debt issuance costs are similar to debt discounts and, in effect, reduce the proceeds of borrowing and increase the effective interest rate. The concepts statement further states that debt issuance costs cannot be an asset because they provide no future economic benefit.

Presentation

Debt issuance costs related to a recognised debt liability will have to be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts.

Recognition and measurement

The guidance in the new standard is limited to the presentation of debt issuance costs. The recognition and measurement guidance for debt issuance costs are not affected by the amendments. So, the amortisation of such costs should continue to be calculated using the interest method and reported as interest expense. The other areas of US GAAP that prescribe accounting treatment for third-party debt issuance costs will not be affected. For example, the new standard will not change the accounting for third-party costs related to debt restructuring accounted for under Accounting Standards Codification (ASC) 470-50, Debt, Modifications and Extinguishments, or impact the calculation of a beneficial conversion feature in accordance with ASC 470-20, Debt with Conversion and Other Options. So, reporting entities may still need to track debt issuance costs separately to address these other areas of US GAAP.

Effective date

For public business entities, the standard is effective for financial statements issued for fiscal years beginning after 15 December 2015, and interim periods within those fiscal years. For all other entities, however, the standard is effective for financial statements issued for fiscal years beginning after 15 December 2015, and interim periods within fiscal years beginning after 15 December 2016. Early adoption is permitted for financial statements that have not been previously issued.

Transition

An entity should apply the new guidance retrospectively, so that the balance sheet of each individual period is adjusted to reflect period-specific effects of applying the new guidance. Upon transition, an entity has to comply with the applicable disclosures for a change in an accounting principle. These disclosures include the nature of and reason for change in accounting principle, transition method, description of retrospectively adjusted prior-period information, and the effect of the change on financial statement line items (i.e. debt issuance cost asset and debt liability).

Benchmark with IFRS/Ind AS

The amendments streamline the requirements under US GAAP with those under IFRS/Ind AS, which state that transaction costs be deducted from the carrying value of the financial liability and not recorded as separate assets.

Benchmarking with existing Indian GAAP

The existing Indian GAAP does not prescribe any explicit guidance on presentation of debt issuance costs, except that AS 16: Borrowing Costs includes amortisation of ancillary costs incurred while arranging borrowings under borrowing costs, and prescribes accounting for them. As a matter of practice, entities charge debt issuance costs to profit and loss, while others defer such debt issuance costs (since they are excluded from the scope of AS 26: Intangible Assets) and present them in the balance sheet, to be amortised over a period of three to five years.

FASB simplifies accounting for defined benefit plans

Background

A reporting entity whose fiscal year-end does not coincide with a month-end may incur more costs than other entities when measuring the fair value of plan assets of a defined benefit pension or other post-retirement benefit plans. This is because information about the fair value of plan assets obtained from a third-party service provider is typically reported as of the month-end. That information is adjusted to reflect the fair value of plan assets as of the fiscal year-end.

What's new?

On 15 April 2015, the FASB issued Accounting Standards Update 2015-04: Compensation—Retirement Benefits, to provide a practical expedient for measurement dates of defined benefit plan assets and obligations.

Key provisions

The practical expedient allows employers whose fiscal year-end dates do not coincide with a month-end (e.g. companies with a 52/53-week fiscal year) to measure pension and post-retirement benefit plan assets and obligations as of the month-end date closest to the fiscal year-end. Entities that choose to apply the expedient are required to adjust the measurement of defined benefit plan assets and obligations for any contributions or significant events (such as a plan amendment, settlement, or curtailment that calls for a re-measurement) that occur between the month-end measurement date used to measure defined benefit plan assets and obligations and an entity's fiscal year-end (intervening period).

However, an entity should not adjust the measurement of defined benefit plan assets and obligations for other events during the intervening period that are not caused by it (e.g. changes in market prices or interest rates).

Interim period

For an entity that has a significant event in an interim period that calls for a re-measurement of defined benefit plan assets and obligations (e.g. a partial settlement), the update permits it to re-measure defined benefit plan assets and obligations using the month-end closest to the date of the significant event.

This month-end re-measurement should be adjusted for any effects of the significant event that may or may not be captured in the month-end measurement (e.g. if the closest month-end is before the date of a partial settlement, then the measurement of plan assets may include assets that are no longer part of the plan). However, an entity should not adjust the measurement of defined benefit plan assets and obligations for other events that occur between the month-end measurement and the date of the significant event and are not caused by it (e.g. changes in market prices or interest rates).

Contributions made during intervening period

If an entity applies the practical expedient and a contribution is made between the month-end date used to measure defined benefit plan assets and obligations and the entity's fiscal year-end, the entity should not adjust the fair value of each class of plan assets for the effects of the contribution. Instead, the entity should disclose the amount of the contribution to permit reconciliation of the total fair value of all classes of plan assets in the fair value hierarchy to the ending balance of the fair value of plan assets at year-end.

For example, assume an entity with a 2 January 2016 fiscal year-end applies the practical expedient and measures its defined benefit plan assets and obligation as of 31 December 2015. If it makes a contribution on 1 January 2016 (i.e. after the measurement date but before the fiscal year-end), it would adjust the funded status of the defined benefit plan recognised in the balance sheet to reflect the contribution as an addition to plan assets. However, it would not be required to adjust the fair value hierarchy and classes of plan assets disclosed in the footnotes. Instead, it should separately disclose the amount of the contribution to reconcile to the fair value of plan assets at the fiscal year-end date.

Effective date

For public business entities, the standard is effective for annual reporting periods beginning after 15 December 2015, including interim periods (i.e. 1 January 2016 for calendar year-end public entities). For all other entities, the standard is effective for annual reporting periods beginning after 15 December 2016, and interim periods within annual periods beginning after 15 December 2017. Early adoption is permitted. If elected, the practical expedients would be applied prospectively.

Transition

The practical expedient for measuring plan assets and obligations at year-end is an accounting policy election that must be applied consistently from year-to-year to all of an entity's defined benefit plans. Entities must disclose their election of the practical expedient.

As this is an accounting policy election, entities would need to adopt it on the effective date of the new standard, or demonstrate that the new policy is preferable if adopted later.

The decision to apply the practical expedient to interim re-measurements for significant events can be made for each individual event. It is not an accounting policy election.

Benchmarking with IFRS/Ind AS/Indian GAAP

IFRS/Ind AS/Indian GAAP does not have a practical expedient that permits an entity to measure defined benefit plan assets and obligations as of the month-end closest to the entity's fiscal year-end (or the month-end closest to the date of a significant event that occurred in an interim period).

Ind AS 101: Starting point of Ind AS journey

Background and scope

As we know, the Ministry of Corporate Affairs (MCA) has notified companies (Indian Accounting Standard) Rules, 2015, and has set the ball rolling for companies to implement Ind AS in a phased manner. Investors and others expect to see Ind AS financial statements for the first time from the year ending 31 March, 2017 (unless voluntarily adopted earlier).

A first-time adopter of Ind AS is expected to retrospectively apply Ind AS in its first Ind AS compliant financial statements, including interim reporting. Acknowledging that the cost and effort of transition may outweigh the benefits from such financial information, Ind AS 101 provides guidance to a first-time adopter comprising certain mandatory exceptions and relief in the form of certain optional exemptions from retrospective application of Ind AS at the transition date.

Principles

The following summarises the requirements of Ind AS 101:

- *Avail the benefits only once*
- *Select accounting policies based on Ind AS effective at the end of the first reporting period, and apply these policies for all periods presented in the first Ind AS financial statements*
- *Apply the mandatory exceptions*
- *Consider whether to apply any of the optional exemptions from retrospective application of Ind AS*
- *Prepare an opening balance sheet at the date of transition, i.e. 1 April 2015 per Ind AS (for phase I companies)*
- *Provide disclosures to explain the transition to Ind AS from previous GAAP (i.e. Indian GAAP)*

Adjustments resulting from the above requirements are recognised on transition in retained earnings (or, if appropriate, another category of equity) at the date of transition, except for reclassifications between goodwill and intangible assets.

Recognition and measurement

The starting point for transitioning to Ind AS is the preparation of an opening Ind AS compliant balance sheet which is the beginning of the earliest period for which an entity presents full comparative information in its first Ind AS financial statements. Subject to the exceptions and exemptions listed below, a first-time adopter, in preparing its opening balance sheet is required to fulfil the following:

- Recognise all assets and liabilities which are required to be recognised by Ind AS, e.g. derivative assets, which may not have been recognised under Indian GAAP
- Not recognise items as assets and liabilities if Ind AS does not permit such recognition, e.g. proposed dividend, currently recognised as a liability
- Reclassify items recognised under previous GAAP as one type of asset, liability or component of equity, but which are a different type of asset, liability or component of equity under Ind AS, e.g. redeemable preference shares currently considered as shareholders fund will get reclassified as a liability
- Apply Ind AS in measuring all recognised assets and liabilities

Mandatory exceptions

Ind AS 101 prohibits retrospective application of Ind AS principles in the following areas:

Estimates	• No benefit of hindsight • To be consistent with estimate as per previous GAAP after accounting policies adjustment, unless instances of error
Derecognition of financial assets and liabilities	• Apply derecognition principles to transactions occurring on or after transition date • Prohibits recognition of financial assets/liabilities that were derecognised under previous GAAP
Hedge accounting	• Prevents retrospective application of hedge accounting • Existing hedges need to be in compliance with Ind AS 109
Non-controlling interest	• Treatment of change in control and loss in control to be applied prospectively • Total comprehensive income attributable to non-controlling interest even if it results in negative balance to be considered prospectively
Classification and measurement of financial assets	• Assessment of classification and measurement needs to be made on the conditions that exist at the date of transition
Impairment of financial assets	• Apply impairment requirements retrospectively, subject to certain exceptions
Embedded derivatives	• Assessment is required at the later of the date, the date when the entity first became party to the contract and the date a reassessment is required per Ind AS 109
Government loans	• Requirement of Ind AS 20 and Ind AS 109 are to be applied prospectively • Fair valuing loans below market rate not required on date of transition

Optional exemptions

Ind AS 101 allows entities to not retrospectively apply Ind AS in 21 areas. Some of the key exemptions are discussed below:

Business combination	• Option available to not restate business combination that occurred before the date of transition
Share-based payments	• Encouraged but not required to apply Ind AS 102 for equity instruments vested or liabilities settled before the transition date
Leases	• Option to determine whether an arrangement contains a lease on date of transition (embedded leases)
Deemed cost–PPE, intangibles, investment property	• Option to fair value or carry forward the previous GAAP carrying amount
Cumulative translation differences	• Cumulative foreign currency translation reserve in relation to foreign operation may be set to zero • Gains or loss on subsequent disposal shall exclude translation differences that arose before the transition date
Investment in subsidiaries, associates and joint ventures	• Option to select between cost per Ind AS 27 or deemed cost, i.e. fair value at the transition date or carrying amount as per previous GAAP
Compound financial instruments	• Need not split a compound financial instrument if liability has been settled and no longer outstanding at the transition date
Long-term foreign currency monetary item	• Option to continue the policy adopted for accounting for exchange differences arising from the translation of long-term foreign currency monetary items recognised immediately before the transition date as per the previous GAAP
Fair value measurement of financial assets and liabilities at initial recognition	• Option to recognise 'day one' gains and losses with respect to a financial instrument, prospectively, to transactions entered into on or after the date of transition to Ind AS
Assets and liabilities of subsidiaries, associates and joint ventures	• Option to measure its assets and liabilities at their carrying values based on either the parent's transition date or subsidiary's own transition date
Joint arrangements/joint ventures	• Investment in JVs shall be measured at the aggregate of net assets proportionately consolidated, considered as deemed cost and tested for impairment
Revenue from contract with customers	• A first-time adopter has certain exceptions with regard to variable consideration, transaction price allocation and restatement of completed contracts
Extinguishing financial liability with equity	• Appendix D of Ind AS 109: Financial Instruments deals with the accounting treatment where an entity renegotiates the terms of its debt, with the result that the liability is extinguished by the entity issuing its own equity shares to the creditor (termed generally as 'debt for equity swaps'). Ind AS 101 gives an option to apply this principle from the beginning of the earliest comparative period presented.

Presentation and disclosure

Reconciliations

An entity is required to explain the impact on balance sheet, financial performance and cash flow due to transition to Ind AS. The below reconciliations are included in the first Ind AS financial statements and interim reporting.

Comparative information

An entity's first Ind AS financial statements shall include at least three balance sheets, two statements of profit and loss, two statements of cash flows and two statements of changes in equity and related notes, including comparative information for all statements presented. So for Phase 1 companies, there will be balance sheets as of 31 March 2017, 31 March 2016, 1 April 2015 and statements of profit and loss, cash flows and changes in equity for the years ended 31 March 2017 and 31 March 2016.

Equity

- Reconiliation at the date of transition to Ind AS
- Reconciliation at the end of the latest period presented under previous GAAP, i.e. comparitive period

Total comprehensive income

- Reconciliation of total comprehensive income with the profit/loss per previous GAAP for the comparitive period

Interim reporting

- Reconciliation of total comprehensive income with the profit/loss per previous GAAP for the comparable interim period
- Reconciliation of equity at the end of the latest period presented under previous GAAP, i.e. comparable interim period

Non Ind AS comparative information and historical summaries

Some entities may provide five-year historical data which could include data prior to the first period for which they present full comparative information in accordance with Ind AS. The standard does not require such summaries to comply with the recognition and measurement requirements of Ind AS. Similarly, some entities may present comparative information in accordance with previous GAAP as well as the comparative information required by Ind AS 1. Entities need to label previous GAAP information as not being in accordance with Ind AS and disclose main adjustments that would make it compliant.

Ind AS 101 vs IFRS 1

Though the guiding principles in Ind AS 1o1 and IFRS 1 are similar, Ind AS 101 has additional mandatory exceptions and optional exemptions, including differences or carve-outs. The key carve-outs are in the following areas:

- IFRS 1 defines previous GAAP as the basis of accounting that a first-time adopter used immediately before adopting IFRS. However, Ind AS 101 defines previous GAAP as the basis of accounting that the first-time adopter used for its reporting requirement in India before adopting Ind AS, i.e. Indian GAAP.
- The adjustment on accounting of exclusion of items recognised in accordance with the previous GAAP and which do not qualify for recognition as an asset or liability under IFRS is required to be adjusted in the retained earnings, under IFRS 1 and in some specific cases, with the goodwill. Under Ind AS 101, in such specific instances where IFRS 1 allows adjustment in the goodwill, under Ind AS it can be adjusted with capital reserve to the extent that such adjustment amount does not exceed the balance available in capital reserve.
- Ind AS 101 provides certain additional optional exemptions relating to long-term foreign currency monetary items and service concession arrangements relating to toll roads.
- Ind AS provides an entity with the option to use carrying values of its property, plant and equipment, as on the date of transition to Ind AS, in accordance with previous GAAP as an acceptable starting point under Ind AS. This is a significant carve-out from the IFRS.

Way forward

The first Ind AS financial statements are not too far away. Companies should carefully evaluate transition provisions and make appropriate selection of accounting options, including their Ind AS accounting policies. This is also the time when a company can decide to align its Ind AS financial statements with and minimise differences from IFRS. The benefit of Ind AS 101 is available only once and will shape the future of a company's Ind AS accounts.

New revenue standard: Applicability date still undecided

The latest update

On 28 April 2015, the IASB voted to propose a deferral of the effective date of the new revenue standard – IFRS 15, by one year until 1 January 2018. The IASB's proposal will retain the option for entities to early adopt the standard. This decision follows the FASB vote earlier in the month to propose the deferral of the effective date by one year, to permit entities to adopt the standard by the original effective date. The FASB issued its proposal on April 29 with a 30-day comment period.

Why is this important?

The IASB's decision is expected to result in continued alignment between the IFRS- and US GAAP-required effective dates, which many believe is important to the capital markets.

The IASB decided that a deferral is necessary to provide adequate time to effectively implement the new revenue standard. Its staff cited several reasons to support the deferral, including:

- maintaining the same effective date as US GAAP,
- providing entities with sufficient time to implement any proposed amendments to the standard,
- recognising the delay in publication of the final standard (in May 2014 rather than in 2013), and
- allowing preparers and auditors adequate time to resolve implementation issues.

The IASB and FASB decisions are not final. The proposals are subject to each of the board's due process requirements, which include a period for public comment.

What's next?

The IASB and FASB discussed several implementation issues related to the new revenue standard at joint board meetings in February and March. The boards concurred on the need to address stakeholder feedback on licences, performance obligations, and certain practical expedients upon transition, but did not agree on the approach. The IASB is expected to recommend more limited clarifications while the FASB changes will be more extensive. The FASB has also decided to propose changes in other areas—such as guidance on collectability and noncash consideration—and new practical expedients for shipping and handling services and presentation of sales taxes collected from customers. The joint discussions are expected to continue in the coming months.

The IASB plans to expose a single package of proposed amendments later this year. In contrast, the clarifications proposed by the FASB will be released for public comment as multiple exposure drafts.

How will India respond?

The corresponding revenue standard under Ind AS, which is Ind AS 115, has been made applicable in line with all other standards based on the roadmap notified by the Ministry of Corporate Affairs. Effectively, Indian corporates, which are required to apply Ind AS in the first phase, will need to implement the new standard from 1 April 2015 to comply with the requirements for comparative information. The proposed deferral by IASB and FASB points to important implementation issues with this standard, as the changes it proposes are far-reaching.

India has adopted the revenue standard early mainly to provide a stable platform for preparers of financial statements. But since IASB/FASB is expected to amend the standard, it is important that Indian regulators and standard-setters closely watch these global developments including the implementation issues, so that necessary guidance can be provided on time.

Recent technical updates

The Companies Act, 2013

Exemptions to private companies

The central government has provided certain relaxations to private limited companies by exempting or modifying certain provisions of the Companies Act, 2013. Some of the significant exemption is in relation to the transactions covered under section 188 with holding, subsidiary, fellow subsidiary or an associate of the company and certain transactions currently covered under section 185 relating to loans to directors, passing of ordinary resolution for approval of ESOP schemes, issue of notice to general meeting etc.

The above relaxations also include modification in Clause (g) of sub section (3) of section 141 (3). Accordingly, appointment as auditors in one person companies, dormant companies, small companies and private companies having paid-up share capital of less than 100 crore INR shall not be considered while determining the limit for a holding appointment as an auditor.

While this notification has brought considerable relief to private companies from the extensive compliance requirements, it does not provide this relief retrospectively. This has led to a unique situation with respect to transactions which were entered into prior to this notification (June 2015). Will these exemptions apply retrospectively or will private companies have to meet the compliance requirements of the Companies Act, 2013prior to June 2015?

Exemptions to Nidhi companies

The central government has provided certain relaxations to Nidhi companies by exempting or modifying certain provisions of the Companies Act, 2013. These include provisions relating to serving documents to shareholders, voting rights, remuneration to directors in certain circumstances and applicability of section 185 for a loan given to a director as a member of the Nidhi company.

The Companies (Amendment) Act, 2015

The Companies (Amendment) Act, 2015 has received the assent of the President on 25 May 2015 and while all the other amendments have been effective from 26 May 2015, the amendments to section 143(12), with respect to thresholds for reporting on fraud and section 188, whereby the audit committee can pass omnibus resolutions, are yet to be notified.

Extension of time for filing the notice of appointment of the cost auditor for FY 2015-16 in Form CRA-2 and filing of the cost audit report to the central government for FY 2014-15 in form CRA-4

It has been clarified that no additional fees will be charged till 30 June 2015 for delayed filing of Form CRA-2 for the financial year commencing on 1 April 2015. Also, no additional fees will be charged till 31 August 2015 for delayed filing of Form CRA 4 with respect to the audit report from the cost auditor for the financial year starting on or after 1 April 2014.

SEBI

Requirements specified under the SEBI (Share Based Employee Benefits) Regulations, 2014

In June 2015, certain minimum disclosure requirements under SEBI (Share Based Employee Benefits) Regulations, 2014 were prescribed in terms of the minimum provisions in trust deed, the terms and conditions of schemes to be formulated by the compensation committee, contents of the explanatory statement to the notice and resolution for shareholders' meeting, information required in the statement to be filed with stock exchange(s) as well as the format of notification for issue of shares.

Institute of Chartered Accountants of India

Guidance Note on accounting for derivative contracts

ICAI has released a guidance note which is applicable for accounting periods beginning on or after 1 April 2016 and earlier application is encouraged. From the date this guidance note comes into effect, the following announcements issued by the Council of the ICAI stand withdrawn:

- Applicability of Accounting Standard (AS) 11 (revised 2003) - The Effects of Changes in Foreign Exchange Rates, with respect to exchange differences arising on a forward exchange contract entered into, to hedge the foreign currency risk of a firm commitment or a highly probable forecast transaction issued on the basis of the decision of the Council at its meeting held on 24-26 June 2004
- Disclosures regarding Derivative Instruments published in 'The Chartered Accountant", December 2005 (pp 927)
- Accounting for Derivatives published in 'The Chartered Accountant", May 2008 (pp 1945)
- Application of AS 30, Financial Instruments: Recognition and Measurement published in 'The Chartered Accountant', April 2011 (pp 1575) to the extent of the guidance covered for accounting for derivatives within the scope of this guidance note.

It is expected to provide the much needed guidance to companies in the absence of a comprehensive accounting standard currently applicable on derivatives.

Auditor's report on consolidated financial statements under the Companies Act, 2013

The Auditing and Assurance Standards Board, under the authority of the Council has issued an illustrative format of the auditor's report on consolidated financial statements, which includes reporting on Companies (Auditors' Report) Order, 2003.

The Auditing and Assurance Standards Board issues guidance on reporting under the Companies (Auditor's) Report Order, 2015 (CARO, 2015) and consequential amendment to the format of the auditor's report of a company

As per the announcement, members have been advised to continue to draw in principle, guidance from the relevant paragraphs of the Statement on the Companies (Auditor's Report) Order, 2003, issued by the ICAI with respect to reporting clauses under CARO, 2015.

Guidance note on reporting under section 143 (3) (f) and (h) of the Companies Act, 2013

The Council of the ICAI, at its 342nd meeting considered and approved the guidance note on reporting under section 143(3)(f) and (h) of the Companies Act, 2013, developed by the AASB of the ICAI.

These subsections pertain to observations or comments of the auditors on financial transactions or matters which may have any adverse effect on the functioning of the company and any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith.

Exposure draft: Application guide on managerial remuneration under the Companies Act, 2013

The draft guide, issued in May 2015, includes the provisions of the Companies Act, Schedule V and Rules and provides application guidance on conditions, eligible limits for remuneration as well as determination of profits for computing remuneration.

Global updates

IFRS

IASB issues exposure draft on a revised conceptual framework for financial reporting

The proposals aim to improve financial reporting by providing a more complete, clear and updated set of concepts that can be used by:

- The IASB when it develops IFRS
- Others to help them understand and apply the standards

The exposure draft is open for comment until 26 October 2015.

IASB issues a new edition of the Essentials on sizing up the balance sheet

The Essentials aims to increase investors' awareness of IFRS and enhance the insights they obtain while analysing information produced by IFRS financial statements. Each issue aims to provide an overview of how a specific accounting standard (or aspect of it) is relevant to the financial statement analysis. In this issue, the IASB explains how investors can leverage notes to the financial statements, in order to compare the banks' balance sheets.

US GAAS

PCAOB issues staff consultation paper seeking comment on the auditor using the work of specialists

The PCAOB issued for public comment, a staff consultation paper on potential standard-setting activities related to the auditor using the work of specialists. The staff consultation paper discusses the increased use and importance of specialists in recent years due, in part, to the increasing complexity of business transactions reported in a company's financial statements. The paper also raises questions about whether PCAOB standards adequately address the auditor's use of the work of an auditor's or a company's specialists, and whether more rigorous standards and specific procedures are needed in this regard to help the auditor respond to the risks of material misstatement in financial statements.

The PCAOB staff is seeking feedback on: (1) current practices, (2) the potential need for changes, (3) possible alternatives to address the issues discussed in the staff consultation paper, and (4) relevant data about potential economic impacts to inform the PCAOB's economic analysis associated with standard-setting in this area.

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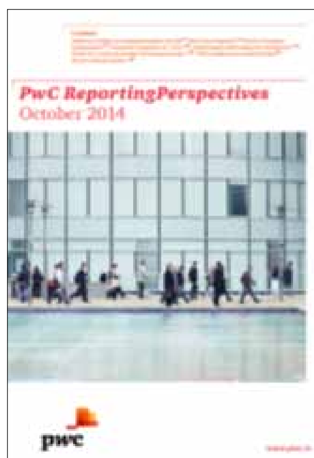

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