PwC ReportingPerspectives

July 2018

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Editorial

We are pleased to bring you the 15th edition of our quarterly newsletter covering the latest developments in financial reporting as well as other regulatory updates.

The Ministry of Corporate Affairs (MCA) notified Ind AS 115, 'Revenue from contracts with customers', on 28 March 2018 as part of the Companies (Indian Accounting Standards) Amendment Rules, 2018. Ind AS 115 is applicable for accounting periods commencing on or after 1 April 2018 for all Ind AS compliant companies. This edition discusses in depth the five-step revenue model of Ind AS 115.

Ind AS 109, 'Financial instruments', requires entities to recognise expected credit losses for all financial assets held at amortised cost, including most inter-company loans from the perspective of the lender. Under Ind AS 109, lenders of inter-company loans will be required to consider forward-looking information to calculate expected credit losses, regardless of whether there has been an impairment trigger. In this edition, we share our insights on Ind AS 109's impairment requirements for inter-company loans.

This edition also summarises the FAQs issued by the Institute of Chartered Accountants of India (ICAI) on Standard on Auditing (SA) 570 (Revised), 'Going Concern' applicable to the audits of financial statements for the periods beginning on or after 1 April 2017 and the revised norms for capital market transactions approved by the Securities and Exchange Board of India (SEBI) in its recent board meeting held on 21 June 2018.

Finally, as always, we have summarised other Indian as well as global regulatory updates.

We hope you find this newsletter informative and of continued interest.

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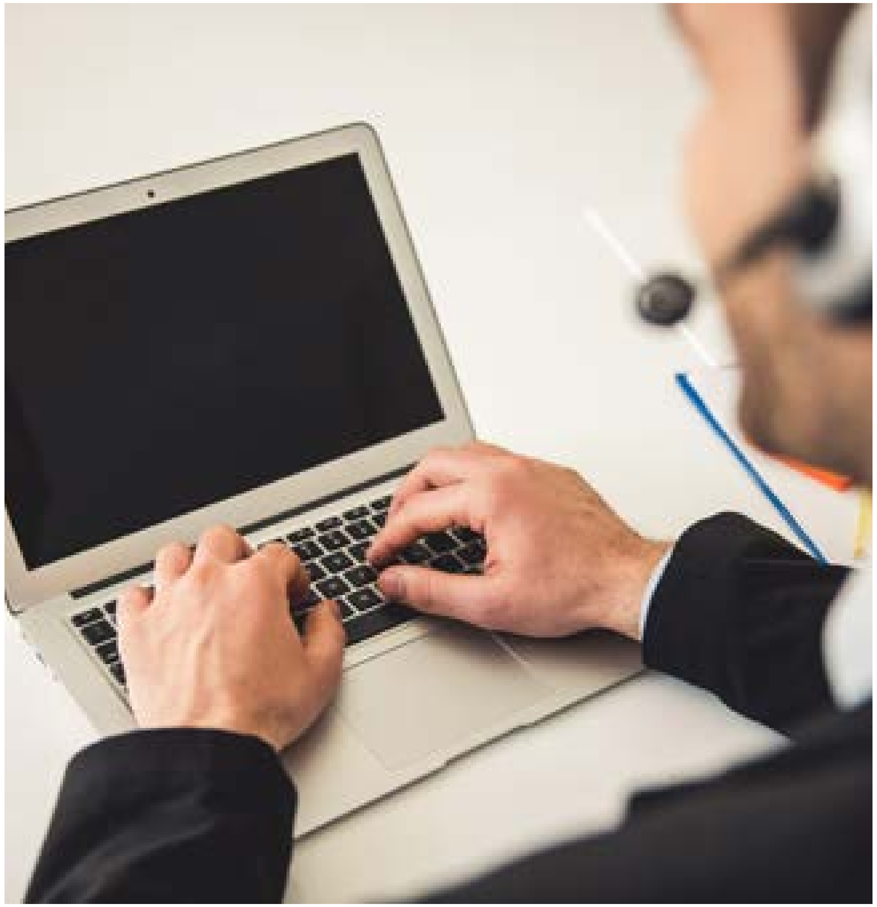


The Ministry of Corporate Affairs (MCA) notified Ind AS 115, 'Revenue from contracts with customers', on 28 March 2018, which is effective for accounting periods beginning on or after 1 April 2018. Ind AS 115 is largely converged with IFRS 15, 'Revenue from contracts with customers' issued by the International Accounting Standards Board (IASB). Ind AS 115 contains principles that an entity will apply to determine the timing and amount of revenue to be recognised. The standard could significantly change how many entities recognise revenue. The standard will also result in a significant increase in the volume of disclosures related to revenue recognition.

In this edition, we summarise the new revenue recognition model.

Five-step revenue model

The core principle of Ind AS 115 is that an entity will recognise revenue to depict the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. This core principle is described in a five-step model framework:

- Step 1: Identify the contract with the customer.
- Step 2: Identify the separate performance obligations in the contract.
- Step 3: Determine the transaction price.
- Step 4: Allocate the transaction price to separate performance obligations.
- Step 5: Recognise revenue when (or as) each performance obligation is satisfied.

Step 1: Identify the contract(s) with customers

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

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

Collectability

An entity will assess at the inception of the contract whether it is probable it will collect the transaction price (see step 3 below). This assessment determines whether a contract exists for the purpose of applying the revenue standard.

The collectability assessment is based on the customer's ability and intent to pay as amounts become due, after considering any price concessions the entity expects to provide. An entity will consider credit risk, but not other uncertainties, such as those related to performance or measurement, as these are accounted for separately as part of determining the measurement and timing of revenue.

Contract modifications

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

A contract modification is treated as a separate contract if the modification adds one or more distinct performance obligations to the contract and the price increases by an amount that reflects the stand-alone selling price of the additional distinct performance obligation(s). Otherwise, a modification is accounted for as an adjustment to the original contract, either prospectively or through a cumulative catch-up adjustment, depending on whether the remaining goods or services in the contract are distinct.

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

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

A change to only the transaction price will be treated like any other contract modification. The change in price will be either accounted for prospectively or on a cumulative catch-up basis, depending on whether the remaining performance obligations are distinct.

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

Step 2: Identify the separate performance obligations in the contract

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

Explicit and implicit promises in a contract to provide goods or services, including promises to provide goods or services that a customer can resell or provide to its customer (an 'end customer'), are performance obligations, even if they are satisfied by another party.

Management will need to determine whether promises are distinct when there are multiple promises in a contract. This is important because distinct performance obligations are the units of account that determine when and how revenue is recognised.

A good or service is distinct only if:

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

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

Example: *A manufacturer enters into a contract with a customer to sell a custom tool and replacement parts manufactured for the custom tool. The manufacturer only sells custom tools and replacement parts together, and no other entity sells either product. The customer can use the tool without the replacement parts, but the replacement parts have no use without the custom tool. How many performance obligations are in the contract?*

Analysis: *There are two performance obligations if the manufacturer transfers the custom tool first because the customer can benefit from the custom tool on its own and the customer can benefit from the replacement parts using a resource that is readily available to it (that is, the custom tool was transferred before the replacement parts). There is a single performance obligation if the manufacturer transfers the replacement parts first, because the customer cannot benefit from those parts without the custom tool, which is not a readily available resource in this fact pattern. The conclusion might differ if the custom tool was sold separately by the manufacturer or other entities.*

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

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

Example: *A contractor enters into a contract to build a house for a new homeowner. The contractor is responsible for the overall management of the project and identifies various goods and services that are provided, including architectural design, site preparation, construction of the home, plumbing and electrical services, and finish carpentry. The contractor regularly sells these goods and services individually to customers. How many performance obligations are in the contract?*

Analysis: *The bundle of goods and services should be combined into a single performance obligation in this fact pattern. The promised goods and services are capable of being distinct because the homeowner could benefit from the goods or services either on its own or together with other readily available resources. This is because the contractor regularly sells the goods or services separately to other homeowners and the homeowner could generate economic benefit from the individual goods and services by using, consuming, or selling them.*

However, the goods and services are not separately identifiable from other promises in the contract. The contractor's overall promise in the contract is to transfer a combined item (the house) to which the individual goods or services are inputs. This conclusion is supported by the fact that the contractor provides a significant service of integrating the various goods and services into the home that the homeowner has contracted to purchase.

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

Step 3: Determine the transaction price

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

Variable consideration and the constraint on revenue recognition

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

In some contracts, penalties are specified. In such cases, penalties shall be accounted for as per the substance of the contract. Where the penalty is inherent in the determination of the transaction price, it shall form part of variable consideration. For example, where an entity agrees to transfer control of a good or service in a contact with a customer at the end of 30 days for 1,00,000 INR and if it exceeds 30 days, the entity is entitled to receive only 95,000 INR; the reduction of 5,000 INR shall be regarded as variable consideration. In other cases, the transaction price shall be considered as fixed.

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

Example: *A contractor enters into a contract with an entity to build an asset for 1,00,000 INR with a performance bonus of 50,000 INR that will be paid based on the timing of completion. The amount of the performance bonus decreases by 10% per week for every week beyond the agreed-upon completion date. The contract requirements are similar to contracts the contractor has performed previously, and management believes that such experience is predictive for this contract. The contractor concludes that the expected value method is most predictive in this case. The contractor estimates that there is a 60% probability that the contract will be completed by the agreed-upon completion date, a 30% probability that it will be completed one week late, and a 10% probability that it will be completed two weeks late. How should the contractor determine the transaction price?*

Analysis: *The transaction price should include management's estimate of the amount of consideration to which the entity will be entitled for the work performed.*

Probability-weighted consideration

1,50,000 INR (fixed fee plus full performance bonus) x 60%	90,000 INR
1,45,000 INR (fixed fee plus 90% of performance bonus) x 30%	43,500 INR
1,40,000 INR (fixed fee plus 80% of performance bonus) x 10%	14,000 INR
Total probability-weighted consideration	1,47,500 INR

The total transaction price is 1,47,500 INR based on the probability-weighted estimate. The contractor will update its estimate at each reporting date. This example does not consider the potential need to constrain the estimate of variable consideration included in the transaction price.

Variable consideration included in the transaction price is subject to a constraint. An entity should recognise revenue as performance obligations are satisfied only if it is highly probable that a change in the estimate of the variable consideration would not result in a significant reversal of the cumulative revenue recognised. This assessment will often require judgement.

Example: *A contractor enters into a contract to construct a manufacturing facility for an auto manufacturer. The contract price is 250 million INR plus a 25 million INR award fee if the facility is completed by a specified date. The contract is expected to take three years to complete. The contractor has a long history of constructing similar facilities. The award fee is binary (that is, there are only two possible outcomes) and is payable in full upon completion of the facility. The contractor will receive none of the 25 million INR fee if the facility is not completed by the specified date.*

The contractor believes, based on its experience, that it is 95% likely that the contract will be completed successfully and in advance of the target date. How should the contractor determine the transaction price?

Analysis: *It is appropriate for the contractor to use the most likely amount method to estimate the variable consideration. The contract's transaction price is therefore 275 million INR, which includes the fixed contract price of 250 million INR and the 25 million INR award fee. This estimate should be updated on each reporting date.*

The following indicators suggest that including an estimate of variable consideration in the transaction price could result in a significant reversal of cumulative revenue:

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

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

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

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

The reach of the variable consideration guidance introduced in the revenue standard is broad and includes amounts that historically might not have been viewed as variable consideration. For example, fixed amounts that an entity is entitled to only upon the achievement of certain events are variable consideration under the revenue standard and included in the transaction price subject to the constraint. Management will need to think broadly about amounts, whether fixed or variable, that will be accounted for as variable consideration.

The evaluation of variable consideration will require judgement in many cases. Entities that defer revenue recognition under current guidance because the price is not reliably measurable could be significantly affected by the new standard. An example is a situation where the price is fixed, but the entity has a history of granting concessions. Entities could be required to recognise some minimum amount of revenue when control transfers as opposed to waiting until the extent of price concessions is resolved. This is because it is unlikely that an entity would be willing to grant a concession for 100% of the price.

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

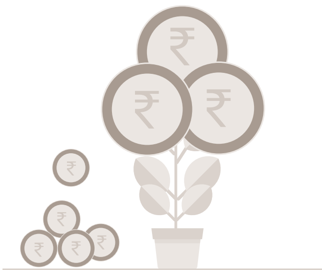
The standard includes a narrow exception to the constraint on variable consideration for sales- or usage-based royalties on licences of intellectual property (IP). Royalties from licences of IP are not included in the transaction price until they are no longer variable (that is, when the customer's subsequent sales or usage occurs). The exception is limited to sales- or usage-based licences of IP and will not apply to other royalty arrangements, and should not be applied by analogy.

Significant financing component

The transaction price should be adjusted for any significant financing component in the arrangement. A practical expedient allows entities to disregard the time value of money if the period between transfer of the goods or services and payment is less than one year, even if the contract itself is for more than one year. In assessing whether a contract contains a significant financing component, an entity should consider various factors, including:

- the length of time between when the entity transfers the goods or services to the customer and when the customer pays for them;
- whether the amount of consideration would substantially differ if the customer paid cash when the goods or services were transferred; and
- the interest rate in the contract and prevailing interest rates in the relevant market.

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



There are two additional situations in which a significant financing component is not present. The first is when a substantial amount of the promised consideration is variable and the amount (or amount and timing) of payment varies due to factors outside the control of the entity or customer (for example, a sales-based royalty). The other is when the difference between the contractual consideration and the cash selling price arises for reasons other than the granting of finance to the entity or the customer (for example, protection against non-performance). The second situation allows entities to consider the intent of the parties when assessing whether a significant financing component is present.

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

An entity needs to determine the discount rate to use when calculating the interest element of a significant financing component. The entity should use a discount rate that reflects what it would charge in a separate financing transaction with the customer, including consideration of any collateral or guarantees it would require. An entity receiving a significant financing benefit (for example, because it received an advance payment) can consider its incremental borrowing rate to determine the interest rate. The discount rate is not reassessed after inception of the contract.

Management will need to evaluate arrangements with customers to determine whether they include a significant financing component. The guidance related to a significant financing component is different than current guidance related to applying the time value of money.

In some cases, it will be clear that a significant financing component exists due to the terms of the arrangement. In other cases, it could be challenging to determine whether a significant financing component exists, especially in some long-term arrangements with multiple performance obligations if goods or services are delivered and cash payments received throughout the arrangement. The standard allows for some level of judgement by requiring entities to assess whether the substance of the payment arrangement is a financing.

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

An entity with contracts that include a significant financing component should consider any operational challenges relating to measuring and tracking the interest element of the arrangement. This could require additional information technology systems, processes, or internal controls to capture and measure such information.

Non-cash consideration

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

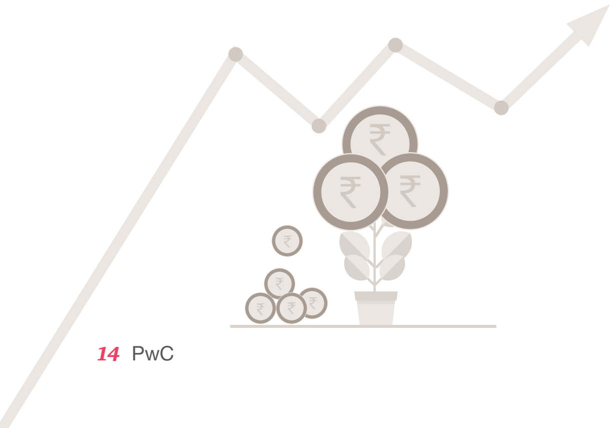
An entity could have a customer that contributes goods or services (for example, materials or labour) to facilitate the fulfilment of a contract. The entity will need to assess whether it obtains control of those contributed goods or services to determine whether they are non-cash consideration and therefore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

Consideration payable to a customer

Consideration paid (or expected to be paid) to a customer or to a customer's customer reduces the transaction price unless the payment is made in exchange for a distinct good or service that the customer transfers to the entity. The definition of distinct is consistent with the guidance in step 2 for identifying performance obligations. An entity will recognise the reduction of revenue when (or as) the later of either of the following events occur:

- the entity recognises revenue for the transfer of the related goods or services to the customer; or
- the entity pays or promises to pay the consideration (even if the payment is conditional on a future event).

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



Example: *A producer sells energy drinks to a retailer, a convenience store. The producer also pays the retailer a fee to ensure that its products receive prominent placement on store shelves (that is, a slotting fee). The fee is negotiated as part of the contract for sale of the energy drinks. How should the producer account for the slotting fees paid to the retailer?*

Analysis: *The producer should reduce the transaction price for the sale of the energy drinks by the amount of slotting fees paid to the retailer. The producer does not receive a good or service that is distinct in exchange for the payment to the retailer.*

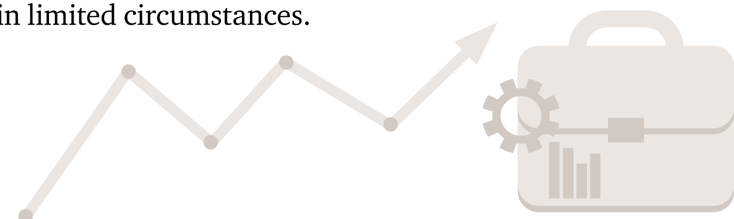
Consideration that is a payment for a distinct good or service is accounted for consistently with how an entity accounts for other purchases from suppliers. If the consideration paid for distinct goods or services is above the fair value of those goods or services, any excess is recorded as a reduction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

Step 4: Allocate the transaction price to separate performance obligations

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

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

- expected cost plus an appropriate margin;
- assessment of market prices for similar goods or services adjusted for entity-specific costs and margins; and
- residual approach, in limited circumstances.



Example: *An entity sells boats and provides mooring facilities for its customers. It sells the boats for 30,000 INR each and provides mooring facilities for 5,000 INR per year. The entity concludes that the goods and services are distinct and accounts for them as separate performance obligations. It enters into a contract to sell a boat and one year of mooring services to a customer for 32,500 INR. How should the entity allocate the transaction price of 32,500 INR to the performance obligations?*

Analysis: *The entity should allocate the transaction price of 32,500 INR to the boat and the mooring services based on their relative standalone selling prices as follows*

Boat	27,857 INR (32,500 INR x (30,000 INR/35,000 INR)
Mooring services	4,643 INR (32,500 INR x (5,000 INR/35,000 INR)

The allocation results in the 2,500 INR discount being allocated proportionately to the two performance obligations.

Residual approach

A residual approach can only be used to calculate the stand-alone selling price of a distinct good or service if the selling price is highly variable or uncertain. It can be applied regardless of whether that good or service is delivered at the beginning or at the end of the contract.

A selling price is highly variable when an entity sells the same good or service to different customers (at or near the same time) for a broad range of amounts. A selling price is uncertain when an entity has not yet established a price for a good or service and it has not been sold previously.

The residual approach requires that an entity first determine if any discounts need to be allocated to specific performance obligations in accordance with the guidance relating to allocation of discounts below prior to using the residual approach to determine the stand-alone selling price of the remaining item(s). If the discount is not allocated to specific performance obligations, management will allocate the discount proportionately to all performance obligations in the contract. When a residual approach is used, judgement will be needed to determine if the amount allocated to the item faithfully depicts the amount of consideration to which the entity expects to be entitled. The residual approach cannot be used, for example, if it results in a very low amount or no consideration allocated to an item.

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

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

Allocating discounts and variable consideration

Discounts and variable consideration will typically be allocated proportionately to all of the performance obligations in the contract. If certain conditions are met, a discount or variable consideration can be allocated to one or more separate performance obligations, rather than to all performance obligations in the arrangement.

An entity should allocate a discount entirely to one or more performance obligation(s) if all of the following criteria are met:

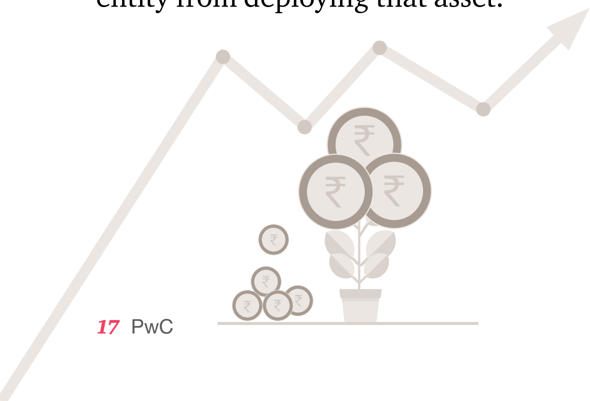
- The entity regularly sells each distinct good or service (or each bundle of distinct goods or services) on a stand-alone basis.
- The entity regularly sells, on a stand-alone basis, a bundle of some of those goods or services at a discount to the stand-alone selling prices of the goods or services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

Changes in the estimate of variable consideration should be allocated entirely to a performance obligation, or to a distinct good or service that forms part of a single performance obligation, if both of the following criteria are met:

- The variable payment relates to a specific performance obligation or outcome from satisfying that performance obligation.
- Allocating the variable amount of the consideration entirely to the separate performance obligation is consistent with the amount of consideration that the entity expects to be entitled to for satisfying that performance obligation after considering all other performance obligations and payment terms in the contract.

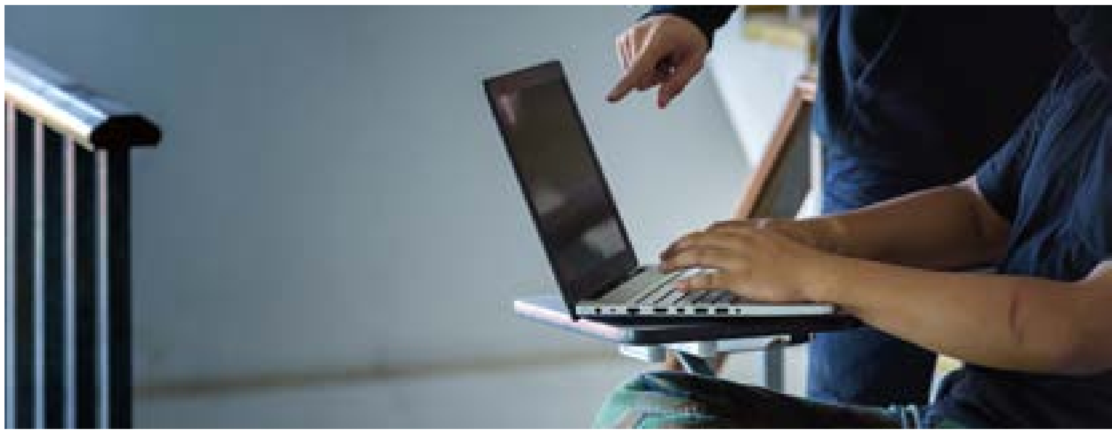
Step 5: Recognise revenue when (or as) each performance obligation is satisfied

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



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

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



Performance obligations satisfied over time

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

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

The first criterion generally addresses service contracts where no asset is created and the customer consumes the services as they are provided. The performance obligation is satisfied over time if another entity would not have to substantially re-perform the work completed to date to fulfil the remaining obligation to the customer. For example, a contract with a customer to provide daily cleaning services of an office building would meet this criterion. Contractual or practical limitations that prevent an entity from transferring a remaining performance obligation to another entity are not considered in this evaluation.

Example: *A freight railway entity enters into a contract with a shipper to transport goods from location A to location B for 1,000 INR. The shipper has an unconditional obligation to pay for the service when the goods reach point B. When should the entity recognise revenue from this contract?*

Analysis: *The entity recognises revenue as it transports the goods, because the performance obligation is satisfied over that period. It will determine the extent of transportation service delivered at the end of each reporting period and recognise revenue in proportion to the service delivered.*

The shipper receives benefit as the goods are moved from location A to location B since another entity will not need to transport the goods to their current location if this entity fails to transport the goods the entire distance. There might be practical limitations to another entity taking over the shipping obligation partway through the contract, but these are ignored in the assessment.

The second criterion addresses transactions where an asset is created or enhanced and the customer controls that asset as it is created. This applies in situations where the customer controls the work-in-progress as the entity manufactures goods. Management should apply the guidance on transfer of control to determine whether the customer obtains control of the asset as it is created.

Example: *A contractor enters into a contract with a refiner to build an oil refinery on land a refiner owns. The contract has the following characteristics:*

- The oil refinery is built to the refiner's specifications and the refiner can make changes to these specifications over the contract term.
- Progress payments are made by the refiner throughout construction.
- The refiner can cancel the contract at any time (with a termination penalty); any work in process is the property of the refiner.

The goods and services in the contract are not distinct, so the arrangement is accounted for as a single performance obligation. When should the contractor recognise revenue from this contract?

Analysis: *The contractor recognises revenue as it builds the refinery because the performance obligation is satisfied over time. The refiner controls the work in process because any work performed is owned by the refiner if the contract is terminated, and it can make changes to the design specifications over the contract term.*

The last criterion addresses situations where the customer does not control an asset as it is created. Management will need to consider whether the asset being created has an alternative use to the entity (if an asset is created) and whether the entity has an enforceable right to payment for performance to date.

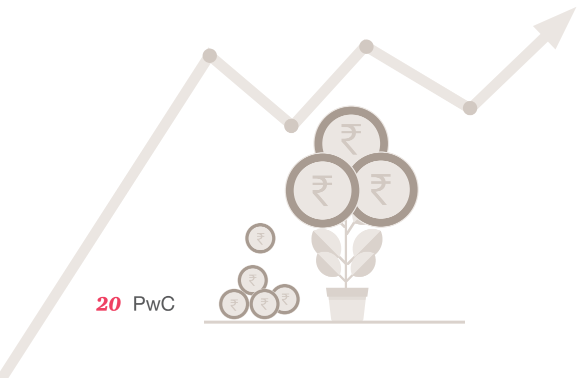
The assessment of whether an asset has an alternative use should be made at contract inception, and not reassessed. Management should consider its ability to redirect its product to another customer, considering both contractual and practical limitations. A substantive contractual restriction that limits management's ability to redirect the asset could indicate the asset has no alternative use. Practical limitations, such as significant costs required to rework the asset so it could be directed to another customer, could also indicate that the asset has no alternative use.

Example: *An entity enters into a contract to manufacture a cruise ship for a cruise line. The ship is designed and manufactured to the cruise line's specifications. The entity could redirect the ship to another customer, but only if it incurs significant cost to reconfigure the ship. Assume the following additional facts:*

- The cruise line does not take physical possession of the ship as it is being built.
- The contract contains one performance obligation as the goods and services to be provided are not distinct.
- The cruise line is obligated to pay the entity an amount equal to the costs incurred plus an agreed profit margin if the cruise line cancels the contract.

How should the entity recognise revenue from this contract?

Analysis: *The entity should recognise revenue over time as it builds the ship. The asset is constructed to the cruise line's specifications and would require substantive rework to be useful to another customer. The entity cannot sell the ship to another customer without significant cost and therefore, the ship does not have an alternative use. The cruise builder also has a right to payment for performance completed to date. The criteria are met for a performance obligation satisfied over time.*



A right to payment exists if an entity is entitled to payment for performance completed to date if the customer terminates the contract for reasons other than the entity's non-performance. A specified payment schedule does not, by itself, indicate the entity has a right to payment for performance to date. The assessment of the enforceability of the right to payment should include consideration of the contract terms and any legal precedent that could override the contract terms.

The right to payment should compensate the entity at an amount that reflects the selling price of the goods or services provided to date, rather than provide compensation for only costs incurred to date or the entity's potential loss of profit if the contract is terminated. This would be an amount that covers an entity's cost plus a reasonable profit margin for work completed.

Management will need to apply judgement to assess the criteria for performance obligations satisfied over time, especially when assessing whether assets have an alternative use and whether the entity has a right to payment for performance completed to date. For example, management will need to assess whether there is a substantive reason for restrictions on transfer of the asset(s) to another party in a contract to determine whether assets have an alternative use. Differences in payment terms could result in the goods being treated as a performance obligation satisfied over time in one case and as inventory transferred at a point in time in another. The 'right to payment' criterion might not be satisfied if the customer only provides reimbursement for the cost of units in production.

Performance obligations satisfied at a point in time

An entity will recognise revenue at a point in time (when control transfers) for performance obligations that do not meet the criteria for recognition of revenue over time.

To determine when a customer obtains control and an entity satisfies a performance obligation, the entity should consider the definition of transfer of control in paragraph 56 and the following indicators:

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

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

Measuring progress towards satisfying a performance obligation

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

- output methods, such as units produced or delivered, contract milestones, or surveys of work performed; and
- input methods, such as costs incurred, labour hours expended, time elapsed, or machine hours used.

Entities using an input method to measure progress should exclude the effects of inputs that do not depict the transfer of control to the customer. An entity sometimes receives materials that a customer controls prior to when those materials are used in the good or service the entity is providing (uninstalled materials). An entity might also incur costs that are attributable to significant inefficiencies in the entity's performance that were not considered in determining the contract price. These situations can create challenges if an entity is using an input method to measure progress. The measure of progress should be adjusted to ensure that it depicts the entity's performance.

The cost of uninstalled materials should be excluded from measuring progress toward satisfying a performance obligation if the entity is only providing a procurement service. A faithful depiction of an entity's performance might be to recognise revenue equal to the cost of the uninstalled materials if all of the following conditions are met:

1. The good is not distinct;
2. The customer is expected to obtain control of the good significantly before receiving services related to the good;
3. The cost of the transferred good is significant relative to the total expected costs to completely satisfy the performance obligation; and
4. The entity procures the good from a third party and is not significantly involved in designing and manufacturing the good (but the entity is acting as a principal).

The standard includes an example that illustrates how management will recognise revenue when significant materials are delivered prior to installation.

Revenue should only be recognised for a performance obligation satisfied over time if the entity can reasonably measure its progress toward complete satisfaction. An entity must have reliable information that can be applied to an appropriate method of measuring progress to meet this objective. An entity that cannot reasonably measure the outcome of a performance obligation, but expects to recover the costs incurred, should recognise revenue only to the extent of the costs until a reliable measure of progress can be made.

What's next?

Entities should carefully evaluate the terms of arrangement and past business practices with customers. The application of the new standard may result in a change from the current recognition and measurement practices. However, the extent of impact would vary based on the industry and current accounting practices followed.

Additionally, the new standard may impact an entity's budgeting and reporting process, IT systems, internal control systems and employee KPIs, including tax implications in many circumstances.

Since Ind AS 115 is already applicable from accounting periods beginning on or after 1 April 2018, entities should focus their effort on effectively completing their transition and implementation processes and timely communication with their stakeholders.

At a glance

Ind AS 109, 'Financial instruments', requires entities to recognise expected credit losses for all financial assets held at amortised cost, including most inter-company loans from the perspective of the lender.

Under Ind AS 109, lenders of inter-company loans will be required to consider forward-looking information to calculate expected credit losses, regardless of whether there has been an impairment trigger.

This article provides guidance on Ind AS 109's impairment requirements for inter-company loans.

Background

Expected credit losses for inter-company loans

Entities applying Ind AS in their separate accounts are required to calculate expected credit losses on all financial assets, including inter-company loans within the scope of Ind AS 109, 'Financial instruments', and which are classified at either amortised cost, or fair value through other comprehensive income (FVOCI). Inter-company positions eliminate in consolidated financial statements. Certain simplifications from Ind AS 109's general 3-stage impairment model are available for trade receivables (including inter-company trade receivables), contract assets or lease receivables, but these do not apply to inter-company loans.

This article discusses which inter-company loans fall within the scope of Ind AS 109 and how to calculate expected credit losses on those that do.

A. Loan is an investment in a group company

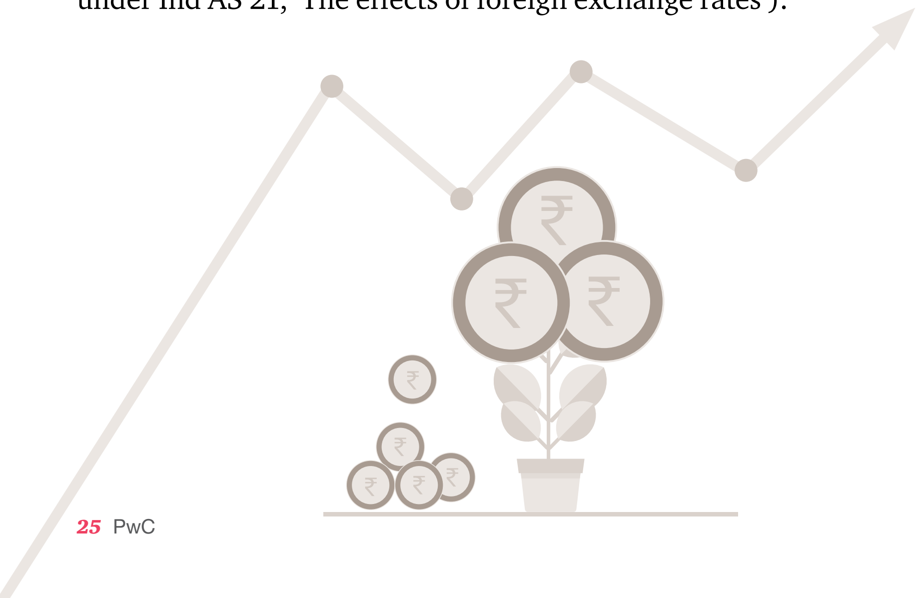
Key points

- Inter-company financings that, in substance, form part of an entity's 'investment in a subsidiary' are not in Ind AS 109's scope. Rather, Ind AS 27, 'Separate financial statements', applies to such investments.
- An inter-company loan is outside Ind AS 109's scope (and within Ind AS 27's scope) only if it meets the definition of an equity instrument for the subsidiary (for example, it is a capital contribution).
- All loans to subsidiaries that are accounted for by the subsidiary as a liability are within Ind AS 109's scope.

Is the inter-company financing within the scope of Ind AS 109 or Ind AS 27?

Financing arrangements between entities within the same group can take various forms. On the one hand, they might be formal contractual lending agreements that are enforceable under local law; on the other hand, they might, in substance, be part of the investment in another entity. The terms of financing arrangements can vary, or might not be clearly defined, with some being repayable on demand, others having a fixed maturity and still others having no stated maturity.

In certain cases, it might be clear that the loan is a debt instrument (and therefore within the scope of Ind AS 109), particularly if there is a legal agreement that creates contractual rights and obligations between the two entities. Ind AS 109 applies to all debt instruments held at amortised cost or FVOCI. This includes 'quasi equity' loans (that is, financings that are accounted for as debt instruments, but have some features of an equity instrument and form part of the net investment in the borrower for foreign currency purposes under Ind AS 21, 'The effects of foreign exchange rates').



In other cases, the financing provided to a subsidiary might represent part of the investment in the subsidiary, and it would be accounted for under Ind AS 27, 'Separate financial statements'. In order for the inter-company financing to comprise part of the investment in the subsidiary, its terms must have the effect that it is an equity instrument of the subsidiary (as defined by para 16 of Ind AS 32, 'Financial instruments – presentation'). This is because Ind AS 109 clarifies that an instrument should be accounted for consistently by the holder and issuer. Consequently, an inter-company financing can only be part of an investment in a subsidiary if it is an equity instrument (that is, there is no contractual obligation for the borrower to repay the financing).

It should also be noted that an entity itself should determine whether an instrument that it holds is an equity or debt instrument, looking to the issuer only for reference. It would not be sufficient for the holder of the instrument to simply replicate the accounting treatment of the issuer, and vice versa, without confirming that such accounting treatment is appropriate.

What if the terms of an inter-company financing are not clear?

If the terms of the inter-company financing are not clear or have not been documented, judgement might be involved in determining whether the inter-company financing is a loan within the scope of Ind AS 109 or is, in substance, part of the investment in the subsidiary under Ind AS 27. If the terms of the inter-company financing are currently not sufficiently clear (for example, it is not clear if or when the financing is repayable), management might wish to clarify the terms to make it easier to assess whether the inter-company financing is within the scope of Ind AS 109 and, if required, to calculate an expected credit loss.

B. Inter-company loans repayable on demand

Key points

- For loans that are repayable on demand, expected credit losses are based on the assumption that repayment of the loan is demanded at the reporting date.
- If the borrower has sufficient accessible highly liquid assets in order to repay the loan if demanded at the reporting date, the expected credit loss is likely to be immaterial.
- If the borrower could not repay the loan if demanded at the reporting date, the lender should consider the expected manner of recovery to measure expected credit losses. This might be a 'repay over time' strategy (that allows the borrower time to pay), or a fire sale of less liquid assets.
- If the recovery strategies indicate that the lender would fully recover the outstanding balance of the loan, the expected credit loss will be limited to the effect of discounting the amount due on the loan (at the loan's effective interest rate, which might be 0% if the loan is interest free) over the period until cash is realised. If the time period to realise cash is short or the effective interest rate is low, the effect of discounting might be immaterial. If the effective interest rate is 0%, and all strategies indicate that the lender would fully recover the outstanding balance of the loan, there is no impairment loss to recognise.

Some inter-company loans between entities within a group are repayable on demand. Such loans might or might not be interest free.

How should a lender calculate expected credit losses for an inter-company loan that is repayable on demand?

Paragraph B5.5.38 of Ind AS 109 notes that the maximum period over which expected impairment losses should be measured is the longest contractual period where an entity is exposed to credit risk. In the case of loans repayable on demand, the contractual period is the very short period needed to transfer the cash once demanded (that is typically one day or less). Therefore, the impairment provision would be based on the assumption that the loan is demanded at the reporting date, and it would reflect the losses (if any) that would result from this.

Considering the 3-stage general impairment model, if the lender uses a PD*LGD*EAD methodology, then the lender of an inter-company loan that is repayable on demand needs to understand:

- the PD ('probability of default') – that is, the likelihood that the borrower would not be able to repay in the very short payment period;
- the LGD ('loss given default') – that is, the loss that occurs if the borrower is unable to repay in that very short payment period; and
- the EAD ('exposure at default') – that is, the outstanding balance at the reporting date.

Paragraph B5.5.38 of Ind AS 109 requires the lender to measure the expected credit loss at a probability-weighted amount that reflects the possibility that a credit loss occurs, and the possibility that no credit loss occurs, even if the possibility of a credit loss occurring is low. For an inter-company loan repayable on demand, there are likely to be two mutually exclusive scenarios: either the borrower can pay today if demanded (that is, it has sufficient highly liquid resources); or it cannot.

If the borrower cannot pay today if demanded, the assessment should consider the expected manner of recovery and recovery period of the inter-company loan (the lender's 'recovery scenarios').

For example, if, at the reporting date, the borrower would be unable to immediately repay the loan if demanded by the lender, the lender might expect that it would maximise recovery of the loan by allowing the borrower time to pay (that is, to continue trading or to sell its assets over a period of time), instead of forcing the borrower to liquidate or sell some or all of its assets to repay the loan immediately.

Similarly, a borrower might, in the past, have paid any excess cash to its parent by way of dividend, which could prevent it from having sufficient available liquid assets to repay its inter-company loan if repayment was demanded. In this case, management of the group might determine that it would maximise recovery of the loan by the borrower ceasing to make such dividend payments in reporting periods where it would not otherwise have sufficient available liquid assets to repay its inter-company loan. However, it should not be assumed that management will support a subsidiary that is otherwise unable to repay an inter-company loan in the absence of a contractual obligation to do so or other supporting evidence (such as a guarantee or letter of comfort, discussed further in Section E). In addition, management should take a holistic view of the group, in particular, since a strategy to support one group entity might give rise to funding issues or potential impairments elsewhere in the group.

If the borrower has sufficient highly liquid assets to repay the inter-company loan if it is demanded today, does that mean that the expected credit loss could be close to zero?

Yes. If the borrower has sufficient available liquid assets (that is, cash and cash equivalents which can be accessed immediately) to repay the outstanding loan if the loan was demanded today, the PD would be close to 0%.

It is important to consider whether the borrower has any more senior external or internal loans which would need to be repaid before the inter-company loan is assessed, since these would reduce the liquid assets available to repay that inter-company loan.

In such a scenario, assuming that the entity has no restrictions on its liquid assets and could meet a demand to repay the loan at the reporting date, any impairment on the inter-company position would likely be immaterial.

If the borrower does not have sufficient highly liquid assets, what are the next steps?

If the borrower does not have sufficient highly liquid assets to repay the loan if demanded at the reporting date, the PD is likely to be higher and might even be close to 100%. This is because, if the loan was called at the reporting date, the borrower would be unable to make repayment. However, as explained above, the PD forms only one part of the expected credit loss calculation. The lender will need to determine what its recovery scenarios are, to understand the LGD if the loan is demanded.

For example, if the lender's recovery strategy would be to require an immediate 'fire sale' of the borrower's assets, it will need to consider the net realisable value of those assets (less any proceeds needed to repay more senior external or internal debt before repaying the inter-company loan) and whether this covers the outstanding balance of the loan. If it does, the expected credit loss will be limited to the effect of discounting the amount due on the loan (at the loan's effective interest rate) over the period until cash is realised. If the time period to realise cash is short or the effective interest rate is low, the effect of discounting might be immaterial. Further guidance on discount rates is given at the end of this section.

In cases where the recovery scenario would be to allow the borrower to continue trading or to sell assets over a period of time (a 'repay over time' strategy), it will be necessary to determine the expected amount that can be recovered over the recovery period. For example, a cash flow forecast might help to give an indication of the expected trading cash flows and/or liquid assets expected to be generated during the recovery period. If these expected trading cash flows and/or liquid assets cover the outstanding balance of the inter-company loan, the expected credit losses will be limited to the effect of discounting the amount due on the loan (at the loan's effective interest rate) over the period until cash is realised and repaid to the lender. If the time period to realise cash is short or the effective interest rate is low, the effect of discounting might be immaterial. Further guidance on discount rates is given at the end of this section.

Cash flow forecasts should consider the quality of any assets being sold, the level of cash or other liquid assets expected to be generated over the period forecasted and the terms of any recovery agreement expected to be entered into with the borrower. The cash flow forecasts also need to incorporate relevant and reliable forward-looking information (including macroeconomic factors) that is probability-weighted. Section E provides further guidance about incorporating forward-looking information into assumptions.

In cases where, under different recovery scenarios, the lender is not able to fully recover the inter-company loan if a demand for payment is made today, expected credit losses might not be immaterial and should therefore be calculated, as explained in Sections D and E below.

What discount rate should the lender use if recovery scenarios are required and the inter-company loan is interest free and repayable on demand?

Ind AS 109 requires the discount rate to be the loan's effective interest rate.

Inter-company loans which are interest free and repayable on demand have an effective interest rate of 0%. Accordingly, for such loans, discounting over the recovery period will have no effect. It follows that, if all recovery scenarios indicate that the full amount of the loan could be recovered, there will be no impairment loss to recognise.

Where the loan is not interest free and the effective interest rate is not zero, if all scenarios indicate that the full amount of the loan could be recovered, any impairment loss is limited to the effect of discounting the amount of the loan (at the loan's effective interest rate) over the period until cash is realised.

C. Low credit risk inter-company loans

Key points

- A loan has low credit risk if the borrower has a strong capacity to meet its contractual cash flow obligations in the near term, and adverse changes in economic and business conditions in the longer term might, but will not necessarily, reduce the ability of the borrower to fulfil its obligations.
- For loans that are low credit risk at the reporting date, Ind AS 109 allows a 12- month expected credit loss to be recognised.
- An external rating of 'investment grade' is an example of low credit risk. However, an inter-company loan should not be assumed to have the same rating as other instruments issued by the borrower (such as loans to third parties) without further analysis.
- Low credit risk loans might have a very low risk of default (or 'probability of default' (PD)).
- A 'shortcut' can be used to determine if the expected credit loss on a low credit risk loan is material. This shortcut assumes that the PD for the inter-company loan is that of the lowest investment grade and the maximum possible loss in the event of a default (that is, the loan is fully drawn and no amount is recovered). If this results in an immaterial expected credit loss, no further work may be required. If, however, this shortcut results in a material expected credit loss, further work will be required to estimate both the actual PD and the actual loss in the event of a default.

A lender holding an inter-company loan that has low credit risk at the reporting date could choose to assume that there has not been a significant increase in credit risk since the loan was first recognised. This allows the lender to calculate a 12-month expected credit loss under stage 1 of the general model, which is a simpler calculation than calculating lifetime expected credit losses under stage 2 or 3 (see Section E below).

One approach for this calculation is PD*LGD*EAD. Loans which are low credit risk typically have very low PDs. Therefore, if it is assumed that the PD is that for a [ICRA] A rated loan (ICRA A being the lowest credit rating that qualifies as low credit risk) and that the LGD is 100% (that is, no collateral, guarantees or other credit enhancements are available), it is possible to apply the assumed PD to the outstanding balance of the loan to understand if there is a material expected credit loss. If it is material, further work is required to refine the PD and LGD to calculate a more accurate expected credit loss. Further information on establishing a PD and an LGD is provided in Sections D and E.

D. Stage 1 inter-company loans and loans whose life is 12 months or less

Key points

- For loans where there has not been a significant increase in credit risk (that is, where they are in stage 1), a 12-month expected credit loss is recognised.
- A similar shortcut could be used as for low credit risk loans to determine if the expected credit loss on a stage 1 loan is material. This shortcut assumes the maximum possible loss in the event of a default (that is, the loan is fully drawn and no amount is recovered). If, when the PD is applied to the outstanding balance of the inter-company loan, this results in an immaterial expected credit loss, no further work may be required. If, however, this shortcut results in a material expected credit loss, further work will be required to estimate the actual loss in the event of a default.

If the lender has assessed that there has not been a significant increase in credit risk since the loan was initially recognised, the loan is in 'stage 1' of the impairment model and a 12-month expected credit loss should be calculated. Similarly, if the loan has a maturity of less than 12 months, lifetime and 12-month expected credit losses will be the same, so 12-month expected credit losses can be calculated.

Once the PD has been determined, a shortcut similar to that used for low credit risk loans can be used to determine if the expected credit loss on a stage 1 loan is material. This shortcut assumes that the LGD is 100% (that is, no collateral, guarantees or other credit enhancements are available) and applies the PD to the full outstanding balance of the loan. If it is material, further work is required to refine the LGD to calculate a more accurate expected credit loss. Further information on establishing an LGD is provided in Section E.

For many 'quasi-equity' loans, it might not be possible to assess whether they are low credit risk, so they are expected to fall within Section D, with management assessing whether there has been a significant increase in credit risk since the 'quasi-equity' loan was first recognised.

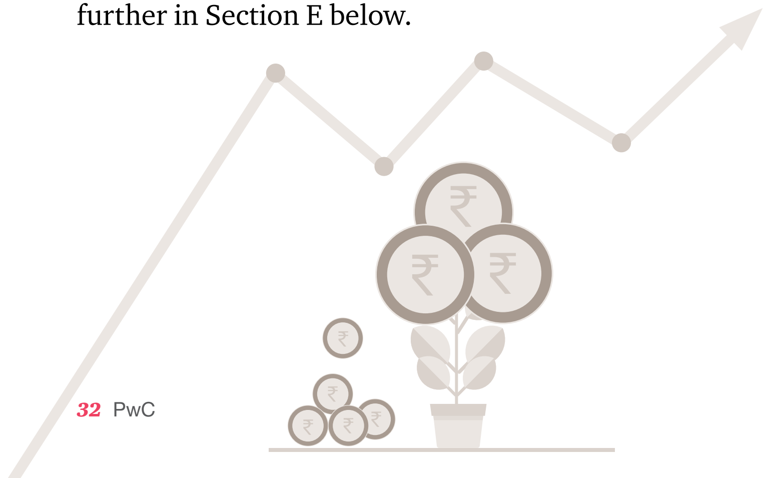
However, even if the PD percentage is very small, where it is applied to a large EAD (for example, 0.1% PD*1 billion INR EAD), a material expected credit loss could still arise if the remaining component of the calculation (that is, the LGD) is assumed to be 100%. In many cases, an LGD of 100% is not realistic, since that assumes that no amount of the loan will be recovered. It is therefore important in such cases to understand the LGD and how it might be estimated; this is because the lower the LGD, the lower the expected credit losses will be.

Since only 12-month expected credit losses are being calculated, a similar approach could be taken to that in Section B for loans repayable on demand to understand the LGD. That is, the lender could consider if the borrower is expected to have sufficient available liquid assets (such as cash and cash equivalents) to cover the full outstanding balance of the loan, or what recovery strategies the lender would take to recover the full outstanding balance of the loan, if the borrower defaulted in the next 12 months.

If there are sufficient available liquid assets at all dates to repay the loan, the expected credit loss is likely to be immaterial. If there are not sufficient available liquid assets at all dates to repay the loan, but the probability-weighted outcome from recovery scenarios that the lender would take indicates that the loan could be fully recovered, the expected credit loss will be limited to the effect of discounting the amount due on the loan (at the loan's effective interest rate) over the period until cash is realised. If the time period to realise cash is short or the effective interest rate is low, the effect of discounting might be immaterial.

As described in Section B, cash flow forecasts supporting the recovery scenarios should include relevant and reliable forward-looking information, which is probability weighted. The cash flow forecasts should be based on the net realisable value of the assets expected to be generated and then realised to repay the loan throughout the period, and not only those available at the reporting date, also taking into consideration the quality of those assets and the terms of their recovery.

Collateral and other credit enhancements (such as guarantees and credit insurance) can also result in a lower LGD. Letters of support can help to provide evidence that the borrower will be supported in the event of default, if 12-month expected credit losses are being calculated. These are explained further in Section E below.



E. Stage 2 and 3 inter-company loans

Key points

- For loans that are in stage 2 or 3, a lifetime expected credit loss is recognised.
- In measuring the expected credit loss, all reasonable and supportable information that is available without undue cost or effort should be considered. This includes both internal and external information, and information about past events, current conditions and forecasts of future economic conditions.
- The effect of credit enhancements such as collateral, guarantees and letters of support should also be included. Guarantees that are contractually enforceable have a greater effect than letters of support that are not.

For inter-company loans that fall within 'stage 2 or 3', a lifetime expected credit loss is recognised.

It will require a PD to be applied that considers the likelihood of default over the whole life of the loan. Since lifetime PDs are higher than 12-month PDs, it is more likely that the inter-company loan will have a material expected credit loss. However, irrespective of the 'stage' at which the inter-company loan sits within the model, collateral and other credit enhancements can result in a lower LGD, which in turn reduces the expected credit loss.

How can an entity establish the PD of the loan?

The lender should take a holistic approach to establish the PD of the loan, taking into account all reasonable and supportable information that it is able to obtain without undue cost or effort relating to the loan. This includes information about past events, current conditions and forecasts of future economic conditions.

The starting point for the lender will generally be to consider the internal information that it holds about the borrower and the loan, which should be supplemented by external information.

Internal information: If the group is sophisticated, it might have developed its own internal credit ratings as part of its credit risk management that can be used to establish the PD of the loan. In any event, the lender should consider any information that it has about the borrower's historical arrears. Ind AS 109 contains rebuttable presumptions that a loan that is 30 days past due has had a significant increase in credit risk (at paragraph 5.5.11), and that a loan that is 90 days past due is credit-impaired (at paragraph B5.5.37).

Management of the lender is expected to consider its inter-company arrangements with the borrower holistically. For example, if the borrower has been granted multiple loans by the lender and is overdue on one loan, it might be more likely that it will default on another inter-company loan, and hence that the other inter-company loan now has a higher PD.

The lender could also consider the interest rates/credit spreads used for transfer pricing on loans to the borrower, which might give an indication of its credit rating.

If the borrower is a lessee needing to calculate an incremental borrowing rate (that is, the rate of interest that a lessee would have to pay to borrow over a similar term, and with similar security, as the lease) for its leases under the new leasing accounting standard, Ind AS 116, this might also give an indication of the borrower's PD, although entities considering Ind AS 116's implementation will be aware that calculating the incremental borrowing rate brings its own challenges.

The lender can also consider the overall financial health of the borrower in developing a PD. For example, if the borrower has positive liquid net assets (that is, excluding goodwill, deferred tax assets, contingent consideration etc.) and a low gearing ratio, the PD might be lower than if the borrower has negative liquid net assets and a high gearing ratio.

Management should ensure that the information used to generate PD estimates is consistent with other internal information, such as that used in cash flow forecasts to assess impairment, deferred tax asset recovery, internal budgets and incremental borrowing rates of leases, where applicable.

External information: If the borrower has any external loans, or is the counterparty to any other instruments such as interest rate swaps, there might be external credit rating information about that entity. As explained in Section C above, external credit ratings are likely to be a useful point of comparison for an inter-company loan's credit rating only where the external loan has the same seniority and terms as the inter-company loan. In addition, where inter-company loan arrangements have previously been established at a market rate of interest, the entity should have information available on how this assessment was made.

External credit ratings agencies, analytics agencies and credit bureaus might directly provide related PD percentages.

External credit ratings are historical, and sometimes lagging, indicators. The lender should carefully consider their relevance and whether the PD should be changed based on forecasts of future economic conditions in the wider economic environment. This might require consideration of factors such as changes in the unemployment rate, interest rates or economic growth, and how this would be expected to flow through to the PD, as discussed further below.

How can an entity incorporate forward-looking information into the PD?

Management will need to do an assessment, based on its historic experience and understanding of the industry/customer base of the borrower, to determine what factors are likely to have the greatest impact on the recoverability of the inter-company loan.

These factors could be general trends and changes in the economy, such as inflation/growth rates, unemployment rates, interest rates and FX rates. In addition, there could be further industry or geography-specific indicators that might have a significant impact on future default levels. These indicators might differ for each inter-company loan/group of inter-company loans, depending on the industry and geography in which the borrowers operate.

One approach might be to look for historical correlation between macro-economic rates (such as unemployment rates) and losses experienced on inter-company loans. If there is such a correlation and unemployment forecast is to be higher or lower than the historical average over the period in which losses have been observed, an adjustment would then be made to the historical amounts (for example, expected higher unemployment might mean that the provision applied to inter-company loans needs to be increased). Under Ind AS 109, entities are expected to consider alternative scenarios to develop a probability-weighted outcome. An entity could use scenario analysis to reflect different possible future outcomes.

In establishing a link to economic data, further complexities might arise due to 'lag'. Consider an electricity provider that has been granted a loan by another entity within its group. A rise in unemployment might not trigger an immediate increase in defaults, because customers prioritise paying electricity bills over other discretionary expenditures. The increase in unemployment might only trigger a rise in PD for the inter-company loan if, for example, it is sustained for a six-month period.

How can an entity establish the LGD of the loan?

LGD is affected by collateral and other credit enhancements, some examples of which are explored below. As for the PD, the LGD should incorporate appropriate forward-looking information. For example, if the collateral backing an inter-company loan was a head office property, expectations about how the Commercial Property Price Index in the relevant geographical area might perform should be factored into the realisable value of the property. A similar approach to that applied above, for calculating the impact of forward-looking information for the PD, could be applied to the LGD.

Collateral: Any collateral pledged to the lender or other security over the loan (for example, the right to seize assets of the entity holding the loan) can reduce the LGD, which could be decreased to an amount that represents the value at which the collateral/asset(s) seized could be sold. Careful consideration should be given as to what drives the value of the assets. If the assets are, by definition, not valuable in the event that the counterparty defaults, those assets would not be effective in decreasing the LGD.

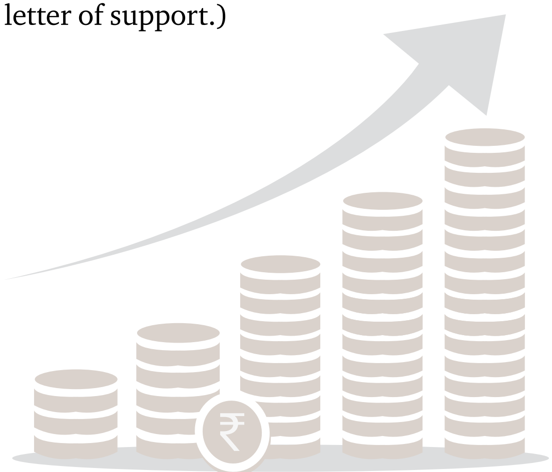
Guarantees: Guarantees are contractually binding and generally come in two different forms. The first type of guarantee would only become effective when a default occurs. This type of guarantee reduces the LGD of the inter-company loan – it does not reduce the likelihood that the borrower will default, and hence it does not affect whether a loan is in stage 1 or stage 2, but it will reduce the loss incurred if the borrower does default. The second type of guarantee becomes effective before a default occurs. Hence, this type of guarantee helps to prevent a default from occurring, and consequently does reduce the PD and can affect whether the loan is in stage 1 or stage 2. If guarantees are present for inter-company loans, either from a bank or another entity within the group, it is therefore important to understand how the guarantee works to appropriately reflect it in the expected credit loss calculation.

Since guarantees are contractually binding, paragraph 5.5.55 of Ind AS 109 states that they should be taken into account in determining expected credit losses; their effect is to reduce the PD/LGD of the inter-company loan, as applicable, to that of the entity providing the guarantee (that is, the bank or other group entity). The entity providing the guarantee might need to record a provision itself based on the likelihood of paying out under the guarantee.

Letters of support: Letters of support can be given in varying circumstances between group entities to support the going concern of an entity. These letters of support could be legally binding or simply an expression of interest. Where these letters of support are not legally binding, and they create no legal obligation between the provider and entity in question, then management should consider its history of supporting entities and its ability to move cash and liquid assets around the group to settle obligations when taking a holistic view about inter-company arrangements.

Whilst letters of support should be taken into consideration when establishing the PD and LGD for the inter-company loan, when they are not contractually binding, they may not reduce the PD and LGD of the inter-company loan to the same extent as a contractual guarantee.

Further, letters of support typically have an effective date of up to 12 months from the date when the financial statements are signed. Thus, they might form one of the considerations when taking a holistic view of information about the borrower if 12- month expected credit losses are calculated for the inter-company loan. If there has been a significant increase in credit risk since inception and lifetime expected credit losses need to be determined, they would only be helpful in considering the PD and LGD for the period that the letter covers. (For example, if a letter of support is effective for one year from when the financial statements are signed, and the financial statements are signed nine months after the reporting period, the letter of support could only be considered for the first year and nine months of the loan's remaining life. If the loan has a remaining life of longer than one year and nine months, the expected credit loss for the period after one year and nine months would not be influenced by the letter of support.)



Letters of credit and credit insurance: Letters of credit and credit insurance might help to reduce the PD of the loan to that of the letter of credit/insurance provider, or reduce the LGD, dependent on whether the letter of credit/insurance reduces the likelihood of a default, or mitigates the loss after a default has occurred (similar to the two types of guarantee described above).

Key takeaway

Ind AS 109 introduces an 'expected loss' model for recognising impairment of financial assets held at amortised cost, including most inter-company loans receivable. However, it is expected that many inter-company loans within the scope of Ind AS 109 might not require a material impairment provision to be recognised, because:

- they are repayable on demand and the lender expects to be able to recover the outstanding balance of the loan if demanded;
- they are low credit risk, so 12-month expected credit losses can be calculated, which might not be material; or
- they have not had a significant increase in credit risk since the loan was first recognised, or have a remaining life of less than 12 months, so 12-month expected credit losses are calculated, which, as noted above, might not be material.

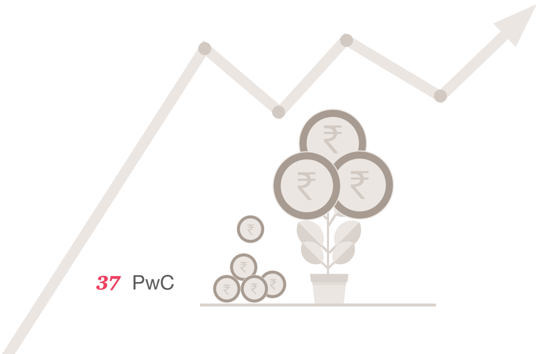
Where inter-company loans do not meet any of the three criteria above, lifetime expected credit losses will need to be calculated, which are more likely to give rise to a material impairment provision. Irrespective of whether calculating expected credit losses for inter-company loans gives rise to a material impairment provision, entities will need to ensure that their approach and the relevant assumptions made are documented.

The ICAI issued revised Standard on Auditing (SA) 570 (Revised), 'Going Concern' applicable to the audits of financial statements for the periods beginning on or after 1 April 2017. SA 570 deals with the auditor's responsibilities in the audit of financial statements relating to going concern and the implications for the auditor's report.

SA 570 (Revised) applies to audits of all entities and includes:

- Management's and the auditor's responsibilities related to going concern.
- A new requirement for the auditor to evaluate the adequacy of disclosures in 'close call' situations.
- If the entity's going concern disclosures are adequate when there is a material uncertainty, a new separate section of the auditor's report is required under the heading Material Uncertainty Related to Going Concern, drawing attention to those disclosures.
- If the entity's going concern disclosures are inadequate, a modified opinion is required.

The Auditing and Assurance Standards Board (AASB) of ICAI received queries from the members with respect to implementation of SA 570 (Revised) for the audit of F.Y. 2017-18. To clarify the implementation issues, the AASB of ICAI, issued the following FAQs on SA 570(Revised):



Question 1: What are the main implications of SA 570 (Revised) for the auditor's report?

Response: The main implications of SA 570(Revised) for the Auditor's Report are summarised below:

Sr. no.	Situation	Reporting requirements in SA 570 (Revised)
1	Use of Going Concern Basis of Accounting in Financial Statements is inappropriate	Adverse opinion
2	Use of Going Concern Basis of Accounting in Financial Statements is appropriate, but a material uncertainty exists:	
	2.1: Case 1: Adequate disclosure of Material Uncertainty is made in Financial Statements	Unmodified opinion but a Separate Paragraph 'Material Uncertainty Related to Going Concern' to highlight material uncertainty
	2.2: Case 2: Adequate disclosure of Material Uncertainty is not made in Financial Statements	Qualified or Adverse opinion

Question 2: Is Emphasis of Matter Paragraph (EOM) also required to be given for the situation where the auditor is required to give Separate Paragraph on 'Material Uncertainty Related to Going Concern' to highlight material uncertainty as per SA 570 (Revised)?

Response:

As per pre-revised SA 570 (which was applicable till audits of FY 2016-17) an Emphasis of Matter Paragraph (EOM, refer paragraph 19) was required to be given in the situation given in case 2.1 as above in question 1. SA 570 (Revised) in such situation requires a separate paragraph 'Material Uncertainty Related to Going Concern' instead of EOM Paragraph.

Accordingly, in situations which warrant separate paragraph on 'Material Uncertainty Related to Going Concern' as per SA 570 (Revised), the auditor is not required to give EOM paragraph.

Question 3: Whether illustrations of auditors' reports given in appendix of SA 570 (Revised) are applicable in respect of audits of FY 2017-18?

Response:

The audit reports for audits of F.Y. 2017-18 are to be issued as per the applicable format of auditor's report prescribed by extant SA 700, SA 705, SA 706 and the illustrative formats given in Appendix of SA 570 (Revised) make reference to new/Revised SAs, i.e. SA 700 (Revised), SA 701, SA 705 (Revised) and SA 706 (Revised) which are not applicable for audits of financial year 2017–18. Therefore, illustrations of auditors' reports given in SA 570 (Revised) are not applicable in respect of audits of FY 2017–18.

Question 4: What will be the manner of reporting under SA 570 (Revised) in audits of FY 2017–18, where use of Going Concern Basis of Accounting in Financial Statements is appropriate, but a material uncertainty exists and adequate disclosure of Material Uncertainty is made in Financial Statements?

Response:

In the given situation, the section 'Material Uncertainty Related to Going Concern' may be included in the below cited manner:

'Material Uncertainty Related to Going Concern

We draw attention to Note XX in the financial statements, which indicates that the Company incurred a net loss of ZZZ during the year ended March 31, 20X8 and, as of that date, the Company's current liabilities exceeded its total assets by YYY. As stated in Note 6, these events or conditions, along with other matters as set forth in Note XX, indicate that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. Our opinion is not modified in respect of this matter.'

Further, this section should be placed immediately after the opinion paragraph and before the EOM/OM paragraph, if any, using the applicable format of auditor's report.

Note: The aforesaid paragraph is illustrative and should be amended appropriately based on circumstances which leads to material uncertainty regarding going concern.

Key takeaway

The FAQs issued by the AASB of ICAI addresses some of the issues faced by the auditors in the implementation of SA 570 (Revised) during the audits of FY 2017–2018.

SEBI, in its board meeting held on 21 June 2018, approved amendments to various SEBI regulations. In this article, we discuss some of the key amendments approved by the SEBI Board in the SEBI (Issue of Capital and Disclosure Requirements) Regulations, (SEBI ICDR Regulations), 2018. These are as follows:

Sr. no.	Topic	Amendments
1	Financial Disclosures in case of public issues/ rights issues	• Financial disclosures to be made for 3 years as against the present duration of 5 years. • Restated and audited financial disclosures in the offer document to be made on consolidated basis only. Audited standalone financials of the issuer and material subsidiaries to be disclosed on the website of the issuer company. • Incorporation of the principles governing disclosures of Indian Accounting Standards (Ind AS) on Indian GAAP (IGAAP) Financials.
2	Promoter group	SEBI ICDR Regulations lays down certain disclosure requirements of promoter group that needs to be incorporated in the offer document. The SEBI board approved the following: • Concept of immediate relative to be retained as against the proposed concept of 'relative'. • The shareholding threshold for identifying promoter group has been revised from 10% to 20%. Now in case the promoter is a body corporate, any body corporate in which the promoter holds twenty percent or more or which holds twenty percent or more of the promoter would be classified as being part of the same promoter group. • Also, in case the promoter is a body corporate, any body corporate in which a group of individuals or companies or combinations thereof, which holds twenty per cent or more of the equity share capital in that body corporate, also holds 20% or more of the issuer, can be classified as promoter group only if they are acting in concert.
3	Disclosures of group companies	SEBI ICDR Regulations requires the issuer company to disclose certain financial information of group companies in the offer document. The SEBI board amended the definition of group companies. The definition has been made more specific by clarifying that group company/ies, shall include such companies (other than promoter(s) and subsidiary/(ies)) with which there were related party transactions, during the period for which financial information is disclosed (3 years), as covered under the applicable accounting standards and also other companies as considered material by the board of the issuer.
4	Announcing price band	The requirement of announcing price band five working days before opening of the issue would be reduced to two working days before opening of the issue.
5	Main Board – IPO - Underwriting provisions to be aligned to requirements of minimum subscription	If 90% of the fresh issue is subscribed in a main board IPO, underwriting will be restricted to that portion only and accordingly the requirement to underwrite 100% of the issue without regard to the minimum subscription requirements has been deleted.
6	Shortfall of up to 10% in minimum promoters' contribution	Shortfall of up to 10% in minimum promoters' contribution may be met by institutional investors such as foreign venture capital investors, scheduled commercial banks, public financial institutions and insurance companies registered with Insurance Regulatory and Development Authority of India, in addition to Alternative Investment Funds, without being identified as 'Promoters'.

Sr. no.	Topic	Amendments
7	Addition to Anchor Investor Category	Insurance companies and foreign portfolio investors except for Category III, promoted by entities related to the lead manager permitted to participate in the Anchor Investor category, in addition to mutual funds promoted by lead managers.
8	Threshold for submission of draft letter of offer to SEBI in case of rights issues	To be increased to 10 crore INR as against the earlier prescribed 50 lakh INR.
9	Company to be eligible to make a fast track rights issue	It should not have any audit qualifications or adverse opinion.
10	SME-IPO	Minimum anchor investor size to be reduced to 2 crore INR from the existing 10 crore INR.

Other updates:

The SEBI Board also approved certain amendments to SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 and reframed a new set of SEBI (Buy-back of Securities) Regulations, 2018. The SEBI board also reviewed regulation and relevant circulars pertaining to Stock Exchanges, Clearing Corporations and Depositories (Market Infrastructure Institutions/ MII) and the proposals thereon.

Key takeaway:

The SEBI board has relaxed the financial information disclosures in the offer document from 5 years to 3 years. Restated and audited financial disclosures in the offer document will now be made on consolidated basis only and audited standalone financials of the issuer and material subsidiaries to be disclosed on the website of the issuer company. The amendments by the SEBI board is a welcome step towards simplifying norms for capital market transactions.

Institute of Chartered Accountants of India (ICAI)

Valuation standards

The Council of the ICAI at its 375th meeting has issued the following valuation standards:

1. Preface to the Indian Valuation Standards
2. Framework for the Preparation of Valuation Report in accordance with the Indian Valuation Standards
3. Indian Valuation Standard 101 - Definitions
4. Indian Valuation Standard 102 - Valuation Bases
5. Indian Valuation Standard 103 - Valuation Approaches and Methods
6. Indian Valuation Standard 201 - Scope of Work, Analyses and Evaluation
7. Indian Valuation Standard 202 - Reporting and Documentation
8. Indian Valuation Standard 301 - Business Valuation
9. Indian Valuation Standard 302 - Intangible Assets
10. Indian Valuation Standard 303 - Financial Instruments

The valuation standards have been issued by the ICAI to set up concepts, principles and procedures which are generally accepted internationally having regard to legal framework and practices prevalent in India. These Indian valuation standards will be applicable for all valuation engagements on mandatory basis under the Companies Act 2013. In respect of valuation engagements under other statutes like Income Tax, SEBI and FEMA, it will be on recommendatory basis for the members of the Institute. These valuation standards are effective for the valuation reports issued on or after 1 July 2018.

Announcement for withdrawal of the Guidance Note on Accounting for Real Estate Transactions (for entities to whom Ind AS is applicable)

The ICAI had issued a Guidance Note on Accounting for Real Estate Transactions (for entities to whom Ind AS is applicable) in May 2016. The guidance note was based on principles of Ind AS 11, Construction Contracts and Ind AS 18, Revenue. On issuance of Ind AS 115, Ind AS 11 and Ind AS 18 stand omitted. Accordingly, the Guidance Note on Accounting for Real Estate Transactions (for entities to whom Ind AS is applicable) has been withdrawn.

EAC opinion: Amortisation of goodwill in respect of subsidiaries and jointly controlled entities recognised as an asset in consolidated financial statements

Facts:

A company operates overseas projects through subsidiaries and joint arrangements. Till 31 March 2016, the company was following previous Indian GAAP and has adopted Indian Accounting Standards (Ind ASs) with effect from 1 April 2016. The transition date of the company is 1 April 2015.

Under the previous Indian GAAP, the company recognised goodwill in respect of subsidiaries and jointly controlled entities in its consolidated financial statements. The company has been amortising goodwill under the previous Indian GAAP. On transition to Ind AS, the company availed the business combination exemption available under Ind AS 101, 'First-time adoption of Ind AS' and continued with the previous Indian GAAP carrying value of the goodwill.

Query:

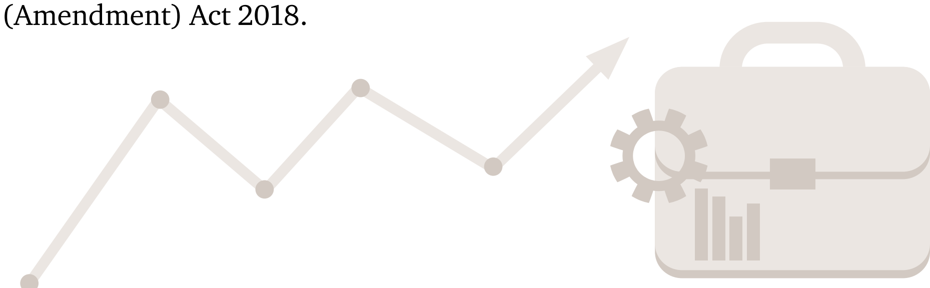
Can the company continue amortisation of goodwill under Ind AS?

View:

The EAC opined that the carrying amount of goodwill (arising on consolidation of subsidiary or jointly controlled entity under the previous Indian GAAP) on the date of transition cannot be amortised under Ind ASs and the carrying amount of goodwill or goodwill acquired under business combination will have to be tested for impairment periodically.

FAQ on accounting treatment of increase in liability due to enhancement of the gratuity ceiling

The Accounting Standard Board of the ICAI issued a FAQ on accounting treatment of increase in liability on account of enhancement of the gratuity ceiling from 10 lakh INR to 20 Lakh INR due to the Payment of Gratuity (Amendment) Act 2018.



Query:

ABC Ltd. is covered by the Payment of Gratuity Act, 1972, which is required to pay gratuity to its employees. Due to the recent amendment in the aforesaid Act, there is a substantial increase in the liability of the company. Is there any exemption or relief available to the company under Accounting Standards with regard to the accounting treatment of such increase in the liability?

Response:

The gratuity benefit is an employee benefit and accordingly any increase in company's liability due to enhancement of the gratuity ceiling from 10 Lakh INR to 20 Lakh INR would be accounted for as per the principles of AS 15, Employee Benefits or Ind AS 19, Employee Benefits, as the case may be.

The effect of above type of amendments need to be dealt with reference to accounting treatment of past service costs. The 'past service cost' is defined as below in AS 15 and Ind AS 19:

As per AS 15, 'Past service cost is the change in the present value of the defined benefit obligation for employee service in prior periods, resulting in the current period from the introduction of, or changes to, post-employment benefits or other long-term employee benefits. Past service cost may be either positive (where benefits are introduced or improved) or negative (where existing benefits are reduced).'

As per Ind AS 19, 'past service cost, which is the change in the present value of the defined benefit obligation for employee service in prior periods, resulting from a plan amendment (the introduction or withdrawal of, or changes to, a defined benefit plan) or a curtailment (a significant reduction by the entity in the number of employees covered by a plan)'.

As per the above, the increase in liability arising due to enhancement of gratuity ceiling from 10 lakh INR to 20 lakh INR is a past service cost. AS 15 or Ind AS 109 do not provide any exemption/one time relief with regard to the accounting treatment of increase in liability arising on account of past service cost.

Accordingly, ABC Ltd. is required to account for any increase in the liability on account of increase in gratuity ceiling as expense as per the requirements of the relevant applicable standard.

Implementation Guide on Reporting Standards (Revised SA 700, Revised SA 705 and Revised SA 706)

The ICAI had issued the revised auditor's reporting standards Revised SA 700 – 'Forming an Opinion and Reporting on Financial Statements', Revised SA 705 – 'Modifications to the Opinion in the Independent Auditor's Report' and Revised SA 706 - 'Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report'. These standards are effective for audits of financial statements for periods beginning on or after 1 April, 2018. To provide guidance to the members on these standards so that they can discharge their reporting responsibilities under these standards effectively, the Auditing and Assurance Standards Board of the ICAI has issued Implementation Guide on Reporting Standards (Revised SA 700, Revised SA 705 and Revised SA 706).

Ministry of Corporate Affairs (MCA)

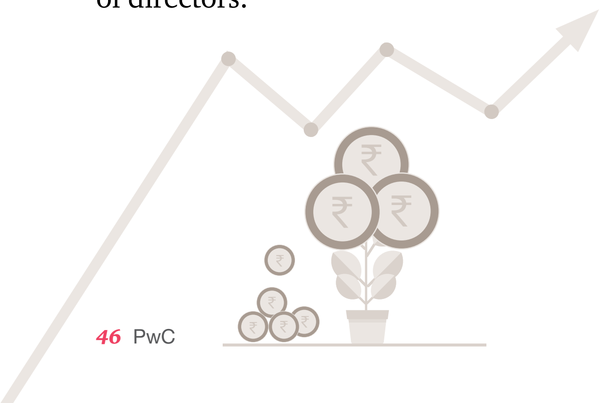
The Companies (Accounting Standards) Amendments Rules, 2018

The MCA has issued the Companies (Accounting Standards) Amendments Rules, 2018. It has substituted paragraph 32 of AS 11, 'The effects of changes in foreign exchange rates'. The amendment states that remittance from a non-integral foreign operation by way of repatriation of accumulated profits does not form part of a disposal unless it constitutes return of the investment. The amendment is effective from 1 April 2018.

MCA notified sections of Companies (Amendment) Act, 2017 and issued amendment to certain rules under the Companies Act 2013

The Companies (Amendment) Act, 2017, received the assent of the Honourable President of India on 3 January 2018. The Amendment Act makes significant changes to the Companies Act 2013 and would come into force on a date of notification in the Official Gazette by central government.

The MCA through its notification dated 7 May 2018 notified 28 sections of the Companies (Amendment) Act, 2017. Additionally, the MCA issued amendments to certain rules under the Companies Act, 2013. Among other matters, the amendments cover the areas such as audit and auditors, loans and investment by companies, meetings of the board of directors, appointment and qualification of directors.



Clarification with respect to provisions under section 135 (5) of the Companies Act, 2013

The first proviso to section 135 (5) of the Companies Act, 2013, requires that the company will give preference to the local areas around which it operates, for spending the amount earmarked for corporate social responsibility activities. In response to concerns raised by the stakeholders regarding non-compliance, the MCA reiterated that these provisions have to be followed in letter and spirit.

Securities and Exchange Board of India (SEBI)

Guidelines for the issuance of debt securities by Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs)

The SEBI has issued Guidelines for the issuance of debt securities by REITs and InvITs. Among other matters, the guidelines state that:

1. REITs/InvITs will follow provisions of SEBI (Issue and Listing of Debt Securities Regulations), 2008, subject to certain conditions.
2. REITs/InvITs will appoint one or more debenture trustee(s) registered with the SEBI under SEBI (Debenture Trustees) Regulations, 1993.
3. Any secured debt securities issued by REITs/InvITs shall be secured by the creation of a charge on the assets of the REIT/InvIT or holding company or special purpose vehicle, having a value which is sufficient for the repayment of the amount of such debt securities and interest thereon.
4. In addition to the disclosure and compliances prescribed under Circular CIR/IMD/DF/146/2016 dated 29 December 2016 and Circular CIR/IMD/DF/127/2016 dated 29 November 2016, REITs/InvITs will be required to comply with following continuous disclosure requirements:

   I. Regulations 50, 51, 54, 55, 56, 57, 58, 59 and 60 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("LODR Regulations") and any other provisions of the aforesaid regulations as may be applicable to REITs/InvITs.

   II. Additional line items that shall be disclosed by REITs/InvITs which have issued/listed their debt securities are as follows:-(a)Asset cover available; (b)debt-equity ratio;(c)debt service coverage ratio;(d)interest service coverage ratio; and (e)net worth.

   III. Modified opinion(s) in audit reports having a bearing on the interest payment or redemption or principal repayment capacity of the REITs/InvITs will be appropriately and adequately addressed by the board of the manager while publishing the accounts for the said period.

   IV. REITs/InvITs will submit to the stock exchange on a half-yearly basis along with the half-yearly financial results, a statement indicating material deviations, if any, in the use of proceeds from the issue of debt securities from the objects stated in the offer document.

SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018

The SEBI has issued the SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018, dated 9 May 2018. Among other areas of corporate governance, the amendment regulations bring changes to (i) composition of the board of directors, (ii) appointment criteria of independent directors, (iii) limitation on maximum number of directorships, (iv) remuneration to executive/non-executive director, (v) board and committee meetings (vi) related party transactions, (vii) financial results (mandatory disclosure of consolidated financial results on a quarterly basis and cash flow statement on a half yearly basis), (viii) secretarial audit, (ix) disclosures in case of unquantifiable audit qualification. Except for the matters specifically provided in the amendment regulations, these changes will come into force with effect from 1 April 2019.

Circular for implementation of certain recommendations of the Committee on Corporate Governance under the Chairmanship of Shri Uday Kotak

The Committee on Corporate Governance under the Chairmanship of Shri Uday Kotak made several recommendations. Most of amendments necessary to implement these recommendations have been made in the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, vide notification dated 9 May 2018. There a few recommendations, as accepted by the Board, which are to be implemented through issue of a circular. Accordingly, provisions relating to following will apply to entities whose equity shares are listed on a recognized stock exchange:

a. Disclosures on board evaluation

The listed entity may consider the following as a part of its disclosures on board evaluation:

I. Observations of board evaluation carried out for the year.

II. Previous year's observations and actions taken.

III. Proposed actions based on current year observations.

b. Group governance unit

I. The listed entity may monitor their governance through a dedicated group governance unit or Governance Committee comprising the members of its board of directors.

II. A strong and effective group governance policy may be established by the entity.

III. The decision of setting up of such a unit/committee or having such a policy shall lie with the board of directors of the listed entity.

c. Medium-term and long-term strategy

The listed entity may consider the following with respect to disclosure of medium-term and long-term strategy of the entity:

I. It may disclose, under the Management Discussion and Analysis section of the Annual report, within the limits set by its competitive position, its medium-term and long-term strategy based on a time frame as determined by its board of directors.

II. The listed entity may articulate a clear set of long-term metrics specific to the company's long term strategy to allow for appropriate measurement of progress.

Clause 4.4 of the previous SEBI Circular No. CIR/CFD/CMD/56/2016 dated 27 May 2016 on the disclosure of the impact of audit qualifications by the listed entities which stated that (where the impact of the audit qualification is not quantified by the auditor, the management shall make an estimate. In case the management is unable to make an estimate, it shall provide reasons for the same. In both the scenarios, the auditor shall review and give the comments), shall stand deleted.

SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018 discussed above has made quantification of audit qualifications mandatory and the auditor is required to review and report on the same, except for the matters like going concern or sub-judice matters.

Reserve Bank of India (RBI)

Basel III Framework on Liquidity Standards – Net Stable Funding Ratio (NSFR) – Final Guidelines

The RBI has issued final guideline on Basel III Framework on Liquidity Standards – NSFR. Among other matters, it requires that banks must publish the NSFR disclosure along with the publication of their financial statements (i.e., typically quarterly or semi-annually), irrespective of whether the financial statements are audited.

Gold Monetization Scheme, 2015

The RBI vide circular dated 7 June 2018 made amendments to the Reserve Bank of India (Gold Monetization Scheme, 2015). Among other amendments, the circular states that the short term deposits will be treated as bank's on-balance sheet liability. These deposits will be made with the designated banks for a short period of 1-3 years (with a facility of roll over). The amendment will come into force immediate effect.

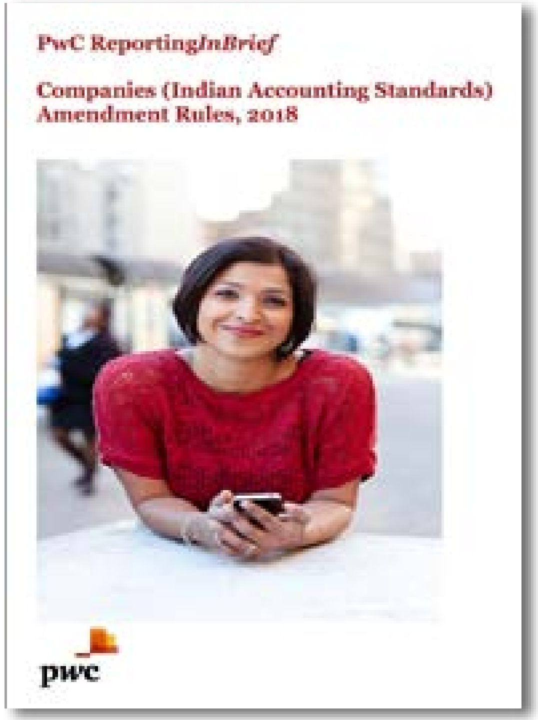
Prudential norms for classification, valuation and operation of investment portfolio by banks: Spreading of mark to market (MTM) losses and creation of Investment Fluctuation Reserve (IFR)

To address the continuing rise in the yields on government securities and also the lack of time to build IFR for many banks, the RBI has decided to grant banks an option to spread provisioning for their MTM losses on all investments held in AFS and HFT for the quarter ending 30 June 2018 as well. The provisioning required may be spread equally over up to four quarters, commencing with the quarter ending 30 June 2018. Banks utilising this option will make suitable disclosures in their notes to accounts/quarterly results providing details of: (i) the provisions made for depreciation of the investment portfolio for the quarter ending June 2018, and (ii) the balance required to be made in the remaining quarters.

Publications (1/3)

https://www.pwc.in/assets/pdfs/publications/2018/value-ind-as-limited-illustrative-ind-as-consolidated-financial-statements-march-2018.pdf

https://www.pwc.in/assets/pdfs/publications/2018/ind-as-presentation-and-disclosure-checklist-2018.pdf



https://www.pwc.in/assets/pdfs/publications/2018/pwc-reportinginbrief-companies-indian-accounting-standards-amendment-rules-2018.pdf

Publications (2/3)

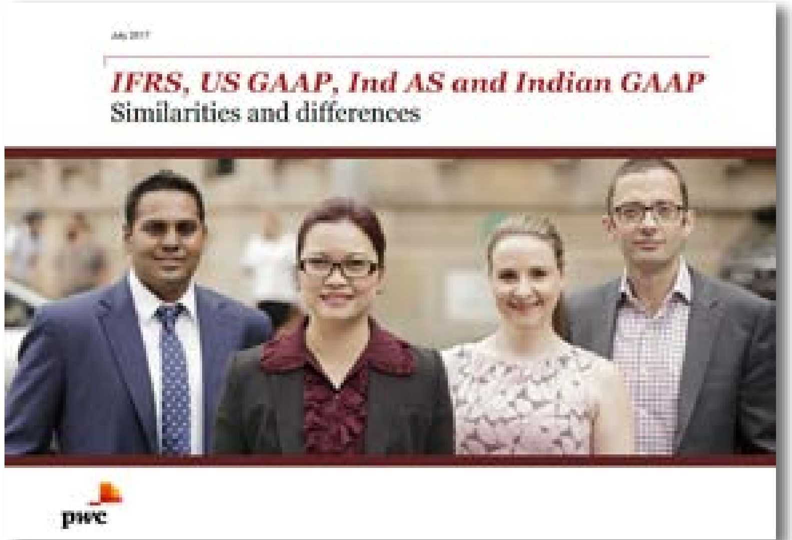
https://www.pwc.in/assets/pdfs/publications/2018/pwc-reportinginbrief-transitioning-to-ind-as-115-revenue-from-contracts-with-customers.pdf

https://www.pwc.in/assets/pdfs/publications/2017/pwc-ind-as-impact-analysis-corporate-indias-transition-to-ind-as.pdf

https://www.pwc.in/assets/pdfs/publications/2018/pwc-reportinginbrief-year-end-reminders-31-march-2018.pdf

Publications (3/3)

https://www.pwc.in/assets/pdfs/publications/2018/pwc-reportingperspectives-april-2018.pdf



https://www.pwc.in/assets/pdfs/publications/2017/ifrs-us-gaap-ind-as-and-indian-gaap-similarities-and-differences.pdf

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