PwC Reporting*InBrief*

Ind AS Technical Facilitation Group (ITFG) Clarification Bulletin 18

In brief

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

This *InBrief* provides an overview of the clarifications issued by the ITFG in its bulletin 18 and our insights on these clarifications and related interpretative issues.

Let's talk

- A first-time adopter who upon transition to Ind AS chooses to continue with the policy adopted under Indian GAAP to account for exchange differences arising from translation of long-term foreign currency monetary items shall not be permitted to apply paragraph 6(e) of Ind AS 23, *Borrowing Costs* to that part of exchange differences arising on long-term foreign currency monetary items that can be considered as an adjustment to interest cost.
- A parent shall recognise tax credit for Dividend Distribution Tax (DDT) paid by the subsidiary in the consolidated financial statements in the period in which it receives dividend, provided the parent reasonably expects at the reporting date that it would be able to avail the tax credit in respect of DDT paid by the subsidiary.
- At initial recognition, a subsidiary shall recognise the difference between the loan amount and fair value of an interest-free loan from its parent as an equity infusion by directly crediting to equity.
- Accounting for business combinations effected through a Court or National Company Law Tribunal (NCLT) approved schemes:
  - Where business combination occurs on or after the date of transition by an entity to Ind AS, the accounting treatment prescribed under the scheme would override the requirements of Ind AS 103, *Business Combinations*; and
  - Where business combination occurred before the date of transition to Ind AS, it has to be evaluated whether the scheme approved by the relevant authority does not preclude restatement upon transition to Ind AS. Restatement is permissible subject to complying with the conditions laid down in this behalf in Ind AS 101, *First-time adoption of Indian Accounting Standards*.
- Ind AS shall not be applicable to a Limited Liability Partnership (LLP). This would be equally applicable even if the LLP was established as a corporate entity and had adopted Ind AS, prior to its date of conversion into a LLP.

In detail

1. **Accounting for exchange differences on long-term foreign currency monetary items by a first-time adopter**

Paragraph 46A of AS 11, *The Effects of Changes in Foreign Exchange Rates,* provides an irrevocable option to an entity to account for exchange differences on long-term foreign currency monetary items in the manner laid out in that paragraph rather than applying the general requirements in the Accounting Standards (AS). Ministry of Corporate Affairs (MCA) had issued a circular clarifying that if an entity chooses to apply the option provided in paragraph 46A of AS 11, then it shall apply the requirements of paragraph 46A of AS 11 to those exchange differences also, that arise on long-term foreign currency borrowings which would be considered as an adjustment to interest cost in accordance with paragraph 4(e) of AS 16, *Borrowing Costs*.

Paragraph D13AA to Ind AS 101 provides a policy choice to a first-time adopter of Ind AS to continue the policy adopted under the previous GAAP for accounting of exchange differences arising from translation of long-term foreign currency monetary items.

ITFG has clarified that if a first time adopter chooses to avail the policy choice provided in paragraph D13AA of Ind AS 101 then it is not permitted to apply paragraph 6(e) of Ind AS 23 to that part of exchange differences arising on long-term foreign currency monetary items that can be considered as an adjustment to interest cost.

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ITFG had clarified in its Bulletin 7 that exemption under paragraph D13AA to Ind AS 101 is available only for exchange differences arising on translation of long-term foreign currency monetary items recognised in the financial statements immediately before the beginning of the first Ind AS financial reporting period.

Let’s consider an entity which had entered into a loan agreement for 100 million USD for construction of property, plant and equipment (PPE). Entity had availed 70 million USD prior to the date of transition to Ind AS. Under Indian GAAP, entity applied paragraph 46A to AS 11 to recognise foreign exchange differences on long-term foreign currency monetary items. Upon transition, entity chooses to continue recognising the foreign exchange differences on long-term foreign currency monetary items in accordance with paragraph 46A to AS 11, as permitted by paragraph D13AA to Ind AS 101.

In this scenario, exchange differences arising on restatement of 70 million USD shall continue to be recognised in accordance with paragraph 46A to AS 11. However, foreign exchange differences arising on restatement of balance loan of 30 million USD may be recognised in accordance with paragraph 6(e) to Ind AS 23 to the extent such exchange differences are regarded as an adjustment to interest cost.

2. Recognition of tax credit on DDT paid by a subsidiary in the consolidated financial statements of the parent

The recognition of DDT credit in the consolidated financial statements of the parent in the period in which the parent receives dividend from a subsidiary is not precluded in circumstances where, based on a proper evaluation of attendant facts and circumstances, the parent reasonably expects at the reporting date that it would be able to avail the DDT credit upon declaration of dividend at its annual general meeting to be held after the end of the financial year.

To summarise:

- At the time of distribution of dividend by a subsidiary to its parent, parent shall recognise in the consolidated financial statements, DDT credit as an asset to the extent is probable that the DDT credit can be utilised. To the extent it is not probable that the DDT credit can be utilised by the parent, the amount of DDT paid by the subsidiary should be charged to the consolidated statement of profit and loss.
- Carrying amount of DDT credit shall be reviewed at the end of each reporting period and the credit shall be reduced or a reduction made in a prior year shall be reversed considering the probability of utilisation of the DDT credit to discharge the DDT liability of the parent.
- At the end of each reporting period, parent should reassess any unrecognised DDT credit. Previously unrecognised DDT credit shall be recognised to the extent it has become probable that a liability for DDT on distribution of dividend by the parent will arise against which the DDT credit can be utilised.

To the extent, DDT credit is utilised to discharge the liability of the parent for payment of DDT liability on distribution of dividend to its shareholders, DDT credit shall be reduced with a corresponding debit to the parent's liability for payment of DDT.

3. Initial recognition of an interest-free loan provided by a parent to its subsidiary

S Ltd received an interest-free loan from H Ltd, its parent. S Ltd is under an obligation to repay the loan and therefore the loan meets the definition of a financial liability in accordance with Ind AS 32, *Financial Instruments: Presentation*. In accordance with Ind AS 109, *Financial Instruments,* S Ltd is required to recognise the loan at its fair value upon initial recognition. Based on the substance of the transaction and in the absence of any factors that could lead to a different conclusion as to its nature, the excess of the loan amount over the fair value of the loan at initial recognition shall be recognised as an equity contribution from H Ltd. The excess shall therefore be credited to the equity in the standalone financial statements of S Ltd.

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Let's consider an example of an interest-free loan provided by H Ltd to S Ltd, its subsidiary. The agreement includes a fixed-term for repayment. There are no transaction costs incurred on the issuance of the loan.

Loan has a fixed repayment term and therefore meets the definition of a financial liability in accordance with Ind AS 32. Subsidiary shall recognise the loan initially at its fair value. Fair value is equal to the present value of future cash to be paid, discounted using the prevailing market rate for a similar instrument (for example, currency, term, type of interest rate, security and other factors) with a similar credit rating. Difference between the fair value of the loan and the amount of loan received from H Ltd should be recognised in accordance with the substance of the transaction. Commonly, the substance is addition to S Ltd's equity. In rare circumstances, the substance might be that the difference represents consideration for something other than the parent acting in the capacity of a parent/ shareholder.

In the books of H Ltd, the difference should be reflected as an additional investment in S Ltd. The loan amount shall be subsequently measured at amortised cost and shall also be subject to impairment requirements under the Expected Credit Loss (ECL) model of Ind AS 109.

4. Restatement of a court approved scheme of amalgamation effected prior to transition to Ind AS

Pursuant to a scheme of amalgamation sanctioned by a High Court order during financial year 2011-12, XYZ Ltd had recognised a particular item belonging to the transferor company as an asset. This item does not meet the definition of an asset under Ind AS. XYZ Ltd is transitioning to Ind AS from 1 April 2017. XYZ Ltd has chosen the policy to retrospectively restate business combinations that have occurred before the date of transition to Ind AS.

In this connection, it has been clarified that:

- Where a business combination occurs on or after the date of transition to Ind AS and the scheme prescribes an accounting treatment that differs from Ind AS 103, the accounting treatment prescribed by the scheme would override the requirements of Ind AS 103.
- Where the business combination had occurred before the date of transition to Ind AS (through a Court or NCLT approval), the question of whether restatement is permissible requires careful evaluation of the stipulations contained in the scheme. Where it is evaluated under law that the scheme approved by the relevant authority does not preclude restatement upon transition to Ind AS, the restatement is permissible subject to complying with the conditions laid down in this behalf in Ind AS 101.

In the fact pattern above, XYZ Ltd needs to independently examine the legal permissibility of the proposed restatement if it wishes to retrospectively apply Ind AS 103.

5. Applicability of Ind AS to a Limited Liability Partnership (LLP)

A LLP is governed by the Limited Liability Partnership Act, 2008. The Companies (Indian Accounting Standards) Rules, 2015 ('the Rules') have been issued by the Central Government pursuant to powers conferred on it by Section 133 read with Section 469 to the Companies Act, 2013.

If a Company gets converted into a LLP, the provisions of the Companies Act, 2013 and the rules framed thereunder cease to apply. Accordingly, Ind AS shall not be applicable to a LLP upon conversion.

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ITFG in its Bulletin 11 had clarified that non-corporate entities are required to follow accounting standards issued by the Institute of Chartered Accountants of India (ICAI). Such entities cannot adopt Ind AS even voluntarily. Therefore, Ind AS is not applicable to partnership firms, LLPs and other forms of non-corporate entities.

If a non-corporate entity is a subsidiary or an associate of a parent or an Investor who is required to prepare consolidated financial statements in accordance with Ind AS, then the non-corporate entity shall separately produce financial information which shall comply with the Ind AS requirements. Therefore, such non-corporate entities may be required to maintain dual set of accounts to meet both Indian GAAP and Ind AS requirements.

Ind AS 101 provides guidance for transition from previous GAAP to Ind AS. There is no similar accounting standard under Indian GAAP which provides guidance for transition from another GAAP to Indian GAAP. Accordingly, this is an area where additional guidance would be helpful.

The takeaway

Clarifications by ITFG are useful for the companies and other stakeholders as they navigate their journey through Ind AS. The current bulletin provides clarity on some of the key issues commonly faced by the stakeholders such as accounting for foreign exchange differences on long-term foreign currency monetary items, recognition of tax credit on DDT in the consolidated financial statements, accounting for intra-group financing arrangements, accounting treatment to be followed under a court or NCLT approved scheme of amalgamation and applicability of Ind AS to a LLP. The clarifications will promote consistency in interpretation and implementation of Ind AS. Entities should however exercise judgement and carefully evaluate the ITFG clarifications whilst applying them to their specific facts and circumstances.

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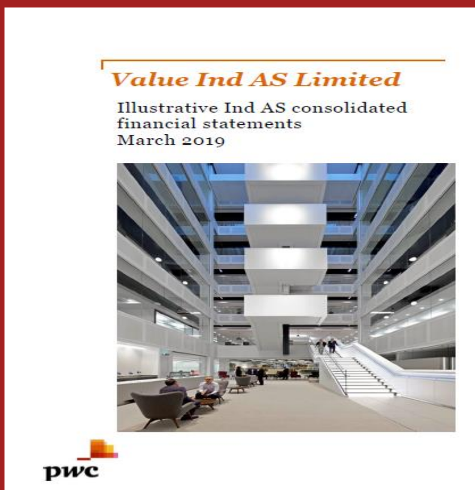

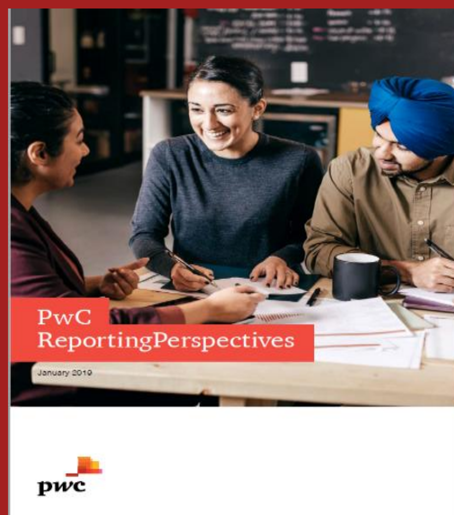

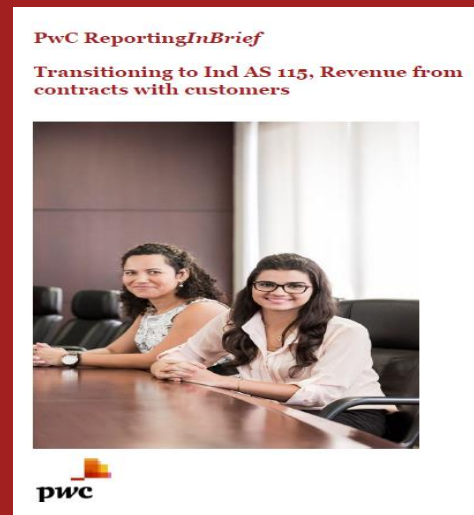

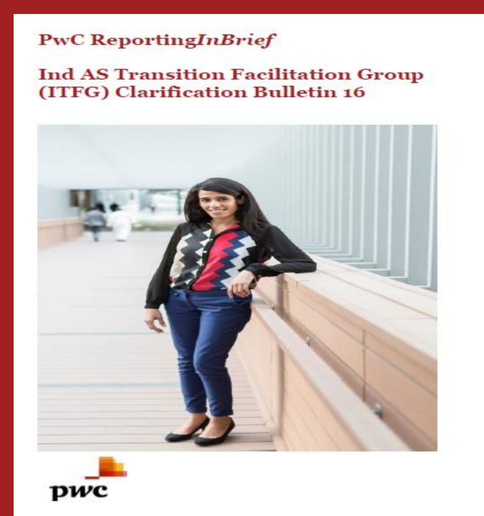

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