PwC ReportingPerspectives

January 2019

Contents

Editorial

We are pleased to bring you the 17th edition of our quarterly newsletter covering the latest developments in financial reporting as well as other regulatory updates.

As per the IFRS convergence status issued by the Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI), Ind AS 116, **Leases**, has been submitted to the Ministry of Corporate Affairs (MCA) for notification. Ind AS 116 is proposed to be effective for annual reporting periods beginning on or after 1 April 2019. This edition discusses the implications of Ind AS 116 for lessors in the real estate industry.

The new standard on auditing (SA) 701, **Communicating Key Audit Matters in the Independent Auditor's Report**, is effective for audits of financial statements for periods beginning on or after 1 April 2018. SA 701 is mandatory in the case of audit of listed entities and places a new reporting requirement on auditors of listed entities to communicate key audit matters (KAM) in their audit reports. This edition discusses some of the FAQs from the implementation guide to SA 701 issued by the Auditing and Assurance Standards Board of the ICAI.

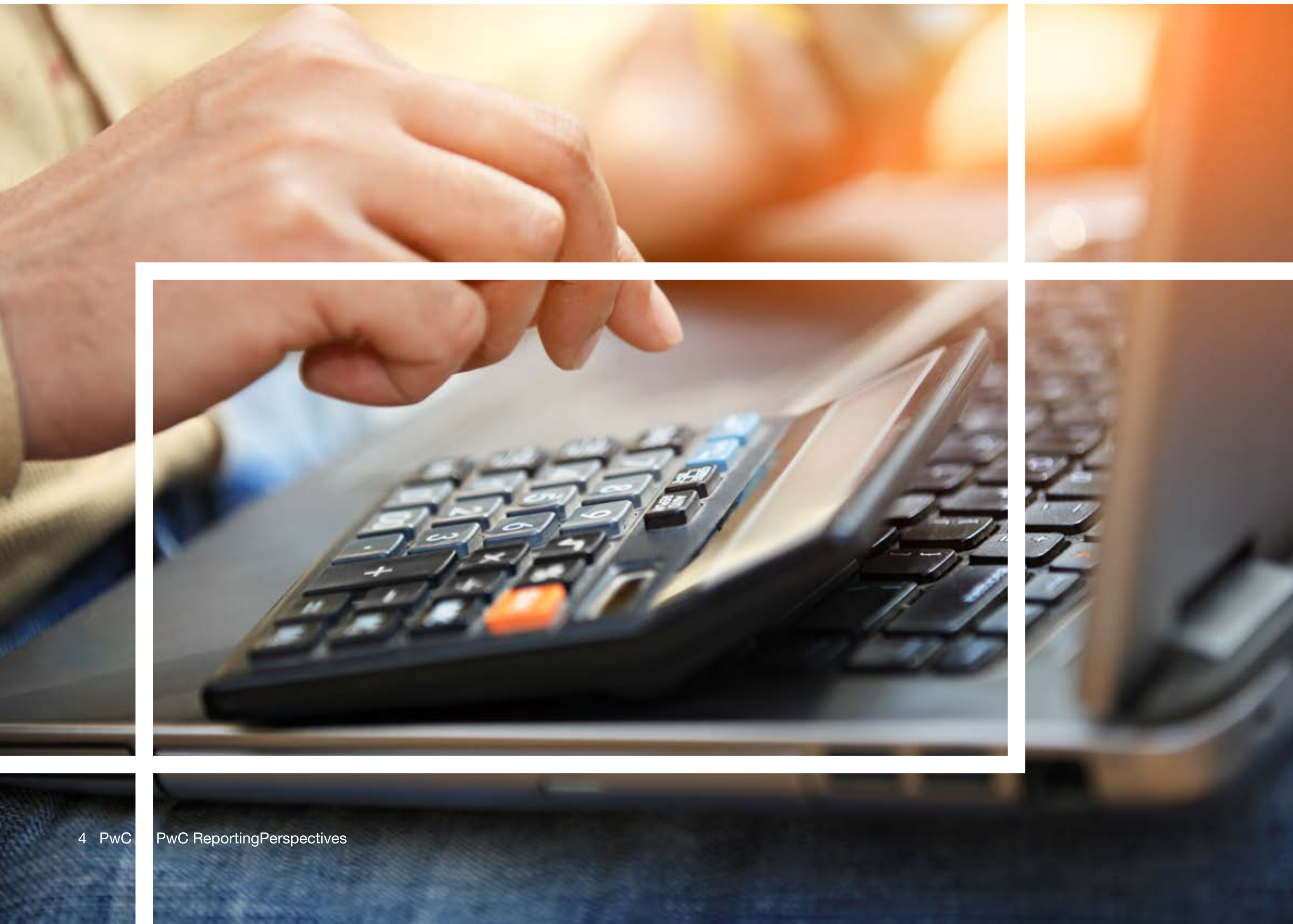
The International Accounting Standards Board (IASB) amended the definition of 'business' in IFRS 3, **Business Combinations**. This edition discusses the key amendments to IFRS 3.

This edition also provides an overview of the key amendments made by the Companies (Amendment) Ordinance, 2019, to the Companies Act, 2013.

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.

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



Ind AS 116 implications for lessors in the real estate industry

As per the IFRS convergence status issued by the ASB of the ICAI, Ind AS 116, **Leases**, has been submitted to the Ministry of Corporate Affairs (MCA) for notification. Ind AS 116 is proposed to be effective for annual reporting periods beginning on or after 1 April 2019. Accounting for lessors under Ind AS 116 remains substantially unchanged from Ind AS 17, **Leases**. Lessors are still required to classify leases as either finance or operating, and the indicators used to make that distinction are again unchanged from Ind AS 17.

For a finance lease, the lessor recognises a receivable at an amount equal to the net investment in the lease; this is the present value of the aggregate of lease payments receivable by the lessor and any unguaranteed residual value.

For an operating lease, the lessor continues to recognise the underlying asset on its balance sheet.

Changes for lessors?

Although the broad mechanics of lessor accounting remain unchanged, a number of topics do affect both lessees and lessors. For example, Ind AS 116 contains revised guidance on the definition of a lease. Further, 'lease term' is defined for both lessees and lessors in the same way (for example, whether or not extension or termination options are taken into account when determining the lease term).

In this article, we focus on specific areas where Ind AS 116 will have a particular impact on lessors:

- lease payments;
- separating or combining components of a contract;
- subleases;
- sale and leaseback transactions; and
- lease modifications.

1. Lease payments

Lease payments are defined in the same way for both lessees and lessors, comprising the following components:

- Fixed payments (including in-substance fixed payments), less any lease incentives receivable by the tenant;
- Variable lease payments that depend on an index or a rate;
- Amounts expected to be payable by the lessee under residual value guarantees;
- The exercise price of a purchase option (if the lessee is reasonably certain to exercise that option); and
- Payments of penalties for terminating the lease (if the lease term reflects the lessee exercising the option to terminate the lease).

Ind AS 116 distinguishes between three kinds of contingent payments, depending on the underlying variable and the probability that they actually result in payments:

i. Variable lease payments based on an index or a rate (e.g. linked to a consumer price index (CPI), a benchmark interest rate or a market rental rate): They are part of the lessor's lease payments. These payments are initially measured using the index or the rate at the commencement date (instead of forward rates/indices).

ii. Variable lease payments based on any other variable: These payments are not based on an index or rate and are not part of the lessor's lease payments, such as payments of a specified percentage of sales made from a retail store. Such payments are recognised in profit or loss in the period in which the event or condition that triggers those payments occurs.

iii. In-substance fixed payments: Lease payments that, in form, contain variability but, in substance, are fixed are included in the lessor's lease payments. The standard states that a lease payment is in-substance fixed if there is no genuine variability.

Example of variable lease payment based on an index or a rate

A lessor agrees with a lessee for an operating lease of office space on the following terms:

1. lease term: 10-year non-cancellable term;
2. annual payment: INR 100,000 in the first year, with a CPI increase in every following year;
3. market rent review: Beginning of year 6, with a CPI increase in every following year.

The lessor initially measures lease income as INR 100,000 in every year. In year 2, CPI increases by 2%.

The lessee is required to remeasure its lease liability when the cash flows change in respect of CPI in year 2 for the lease payments from years 2 to 5. The lease payments from years 6 to 10 would not be remeasured, because those cash flows would not have changed yet. These cash flows would only change when the market rent review occurs and rent is reset to the market rate at that time.

From year 2, the following lease income is forecast for the purposes of the lessor determining recognition of lease income on a straight-line basis:

Year	2	3	4	5	6–10 (annual)
Lease income (INR)	102,000	102,000	102,000	102,000	100,000

Should the lessor remeasure the lease income to be recognised in year 2?

Response:

Given the guidance for lessees, it would be logical for the lessor to remeasure lease income to be recognised in the same way. Therefore, the rental income recognised in year 2 would be INR 100,889, reflecting recognition of the revised income above on a straight-line basis, i.e. (INR 102,000 x 4+ INR 100,000 x 5) divided by 9. However, there is no explicit requirement in Ind AS 116 for a lessor to remeasure its lease income in the same way as a lessee. An alternative approach would be to recognise the increases in rental income related to CPI changes in the periods in which those changes occur in accordance with Ind AS 116 paragraph 38. Under that approach, the rental income in year 2 would be INR 102,000. The method applied is an accounting policy choice, and it should be applied consistently to all leases in accordance with Ind AS 8, **Accounting Policies, Changes in Accounting Estimates and Errors**.

For lessees, in relation to payments initially excluded from the lease liability, if the variability is resolved at a later point in time (for example, insurance premiums or taxes become known and unavoidable for the upcoming year), they become in-substance fixed payments at that point in time in accordance with Ind AS 116 paragraph B42. However, there is no similar explicit requirement in Ind AS 116 for a lessor under an operating lease. Lessors could apply the guidance for lessees or, alternatively, they could recognise the variable lease payments in the periods in which they occur. The method applied is an accounting policy choice, and it should be applied consistently in accordance with Ind AS 8.

2. Separating or combining components of a contract

Contracts often combine different types of obligations, and they might contain a combination of lease components, or of lease and non-lease components. For example, real estate arrangements often require the lessee to reimburse the lessor for certain costs related to the leased asset, such as insurance, property taxes or common area maintenance provided by the lessor. Ind AS 116 requires each separate lease component to be identified and accounted for separately.

1. Interaction with Ind AS 115

The right to use an asset is a separate lease component from other lease components if two criteria are met:

a. The lessee can benefit from the use of the asset either on its own or together with other readily available resources.

b. The underlying asset must not be highly dependent on or highly interrelated with other underlying assets in the contract.

PwC observation

Ind AS 115 contains guidance on how to evaluate whether a good or service promised to a customer is distinct for lessors. A question arises as to how Ind AS 116 interacts with Ind AS 115.

For a multi-element arrangement that contains (or might contain) a lease, the lessor has to perform the following assessment:

- Apply the guidance in Ind AS 116 to assess whether the contract contains one or more lease components.
- Apply the guidance in Ind AS 116 to assess whether different lease components have to be accounted for separately.
- After identifying the lease components under Ind AS 116, the non-lease components should be assessed under Ind AS 115 for separate performance obligations.

The criteria in Ind AS 116 for the separation of lease components are similar to those in Ind AS 115 for analysing whether a good or service promised to a customer is distinct.

When identifying non-lease components, an entity must consider whether a good or service is transferred to the lessee (Ind AS 116 para B33). As mentioned earlier, real estate arrangements often require the lessee to reimburse the lessor for items such as insurance, property taxes or common area maintenance provided by the lessor. There will usually be (at least) one lease component (the right to use the real estate) and one non-lease component (such as common area maintenance). However, payments for insurance and property taxes typically do not involve a transfer of a separate service, and they generally do not represent a separate lease or non-lease component. Instead, these payments form part of the consideration for the lease and non-lease components.

2. Determine overall consideration

The overall consideration in the contract needs to be determined. This will include payments for the lease component(s), and it might also include payments for non-lease components and/or payments that do not represent separate components. Overall consideration includes both fixed and any variable payments. For example, in some real estate arrangements, the payments received from the tenant for property taxes and insurance might be variable payments.

3. Allocation of consideration

When the lease and non-lease components have been identified, the consideration within the contract must then be allocated. Lessors allocate consideration in accordance with Ind AS 115, on the basis of stand-alone selling prices of the identified components. Where insurance and property taxes do not represent a separate component, no consideration is allocated to them; consideration is only allocated to the identified lease and non-lease components. The example below explains how the variable payments of property tax and insurance would be measured when determining the overall consideration.

Example: How are variable payments of property tax and insurance measured?

A lessor requires a lessee to reimburse the lessor for property taxes and insurance under an operating lease. Applying Ind AS 116 paragraph B33, the lessor has determined that, in this specific situation, the payments for property taxes and insurance do not transfer a separate good or service, so they are not accounted for as a separate non-lease component. The lease contract has no other service or non-lease components, and so these tax and insurance payments are allocated as lease payments to be received and recognised as rental income over the lease term.

Often, payments for reimbursing the lessor for property taxes and insurance are variable. Depending on the specific facts and circumstances in each lease, there might be different causes of variability. Potential types of variable payment and how they could be measured are considered further below, although there is significant judgement involved.

Property tax:

Property tax might be calculated as the tax value of the property multiplied by a fixed percentage. The tax value of the property might be determined based on specific requirements in tax law, and so it might not be representative of market value.

Even if valuation of the property takes into account market indices or rates, it is not, in itself, an index or a rate. Hence, these types of property taxes should be accounted for as variable lease payments that do not depend on an index or a rate. Only the amounts that are already in-substance fixed are included in the initial measurement of lease income. For example, if the property taxes are known for the first year and will then be reassessed from the second year, only the property taxes for the first year would be included initially, and the income for property taxes in future periods would be recognised when they occur or become in-substance fixed.

Insurance:

The initial amount of the insurance premium might be known by both parties but not explicitly stated in the contract. Furthermore, the amount might change over time for reasons other than the market value of the property – for example, if the insurance company's assessment of risk changes or the lessor moves to another insurance company.

The amount of premiums might vary in subsequent periods. Amounts received in relation to insurance meet the definition of variable lease payments, but they are not dependent on an index or a rate. Only the amounts that are already in-substance fixed are included in the initial measurement of lease income. For example, if the insurance premium is known for the first year and will then vary from the second year, only the insurance premium for the first year would be included initially, and the income for insurance in future periods would be recognised when it occurs or becomes in-substance fixed.

Lessees will include payments for property taxes and insurance as part of the lease liability if they are linked to a rate or an index or are in-substance fixed payments and are not separate goods or services under the lease.

Similarly, lessors will include payments for property taxes and insurance as part of rental income. As a result, the lessor will record rental income for amounts received in respect of property taxes and insurance. The lessor also records an expense for the costs incurred for these items.

3. Subleases

Intermediate lessors must now classify subleases based on the right-of-use asset from the head lease, rather than the underlying lease asset (as under Ind AS 17).

For example, the term of a property sublease would be compared to the term of the head lease when assessing whether the lease is for the major part of the economic life.

Similarly, the present value of lease payments is compared to the fair value of the right-of-use asset, instead of the underlying asset, when assessing whether it is for substantially all of the fair value.

Since the head lease term for a property lease or the fair value of a right-of-use asset is often shorter than the life or fair value of the underlying property, there is now an increased likelihood that a sublease may be classified as a finance lease. The change to sublease guidance must be considered both on transition to Ind AS 116 for existing subleases and for all new subleases entered into once Ind AS 116 applies.

Practical impact

Real estate companies can often hold investment properties that are located on leased land. In turn, these ground leases are often for long periods of time, for example 99 years. Therefore, real estate companies are lessees in respect of the ground lease and are required to apply Ind AS 116.

As a result, real estate companies will recognise a right of use asset and lease liability in relation to ground leases. In turn, the right-of-use asset is classified as an investment property given that the leased land is held solely for the purposes of holding the related investment property building.

4. Sale and leaseback transactions

Additionally, the accounting for sale and leaseback transactions is one of the main areas in which the new lease standard changes the current guidance. The accounting for sale and leaseback transactions under Ind AS 17 mainly depended on whether the leaseback was classified as a finance or an operating lease. Under Ind AS 116, the determining factor is whether the transfer of the asset qualifies as a sale in accordance with Ind AS 115. To make this assessment, an entity should apply the requirements for determining when a performance obligation is satisfied in Ind AS 115.

Transfer of the asset is a sale

If the buyer-lessor has obtained control of the underlying asset and the transfer is classified as a sale in accordance with Ind AS 115, the seller-lessee measures a right-of-use asset arising from the leaseback as the proportion of the previous carrying amount of the asset that relates to the right of use retained. The gain (or loss) that the seller-lessee recognises is limited to the proportion of the total gain (or loss) that relates to the rights transferred to the buyer-lessor.

If the consideration for the sale is not equal to the fair value of the asset, any resulting difference represents either a prepayment of lease payments (if the selling price is below market terms) or additional financing (if the selling price is above market terms). The same logic applies if the lease payments are not at market rates. The buyer-lessor accounts for the purchase in accordance with applicable standards (such as Ind AS 40, **Investment Property** if the underlying asset is investment property), and for the leaseback in accordance with Ind AS 116.

Example: Sale and leaseback transaction

Entity A owns a property with a carrying value of INR 3 million, and it enters into a sale and leaseback transaction. The market value of the property is INR 10 million. The present value of minimum lease payments under the term of the leaseback is INR 5 million. The initial sales price and the ongoing rental are all at market value.

Under Ind AS 116, the right-of-use asset retained by entity A as a proportion of the underlying asset is 50%, i.e. present value of minimum lease payment (INR 5 million) divided by the market value of the property (INR 10 million).

The right-of-use asset retained is INR 1.5 million: Carrying amount of the property (INR 3 million) x proportion of the underlying asset (50%).

The gain on sale is INR 3.5 million, being the proportion of the total gain that relates to the rights transferred to the buyer-lessor:

$$= \frac{\text{Total gain (INR 7 million) x market value of the property } \textbf{(INR 10 million)} \text{ less the present value of the lease payment } \textbf{(INR 5 million)}}{\textbf{Market value of the property (INR 10 million)}}$$

Under Ind AS 17, assuming the transaction qualifies as an operating leaseback, the gain on sale would be INR 7 million, being the difference between the fair value of the property (INR 10 million) and its carrying value (INR 3 million). Further, no asset or liability would be recognised on the balance sheet subsequent to the transaction. However, under Ind AS 116, the gain recognised relates only to the proportion of the right to use the underlying asset that is transferred to the buyer-lessor.

Transfer of the asset is not a sale

If the transfer is not a sale (that is, the buyer-lessor does not obtain control of the asset in accordance with Ind AS 115), the seller-lessee does not derecognise the transferred asset, and it accounts for the cash received as a financial liability. The buyer-lessor does not recognise the transferred asset, and instead it accounts for the cash paid as a financial asset (receivable).

Impact:

The accounting treatment for sale and leaseback transactions for seller-lessees under Ind AS 116 can be significantly different from Ind AS 17. However, we do not expect this difference to result in a complete elimination of sale and leaseback activity. There are still valid commercial reasons for seller-lessees to enter into such transactions, such as managing cash flows, facilitating operational decisions, and tax considerations.

5. Lease modifications

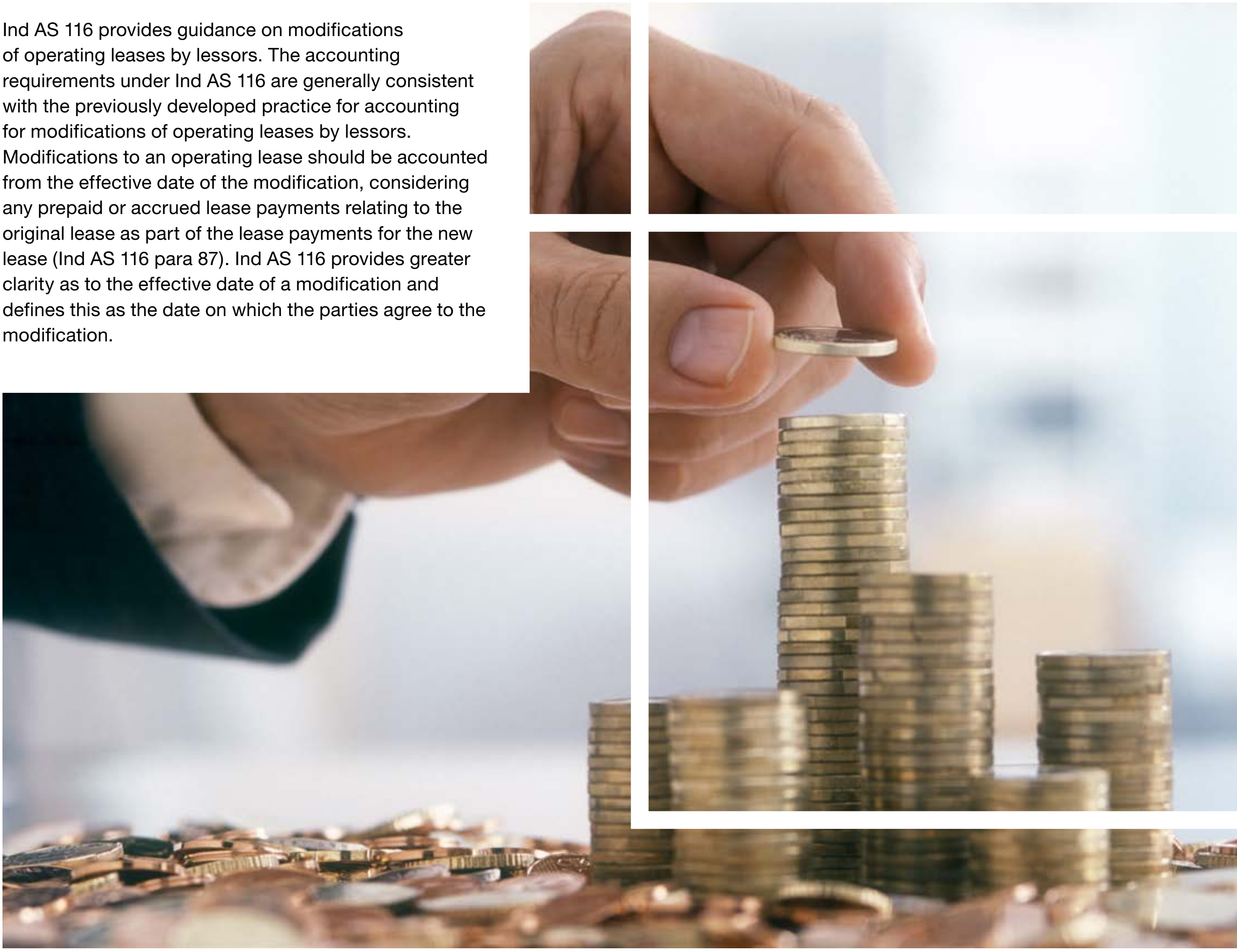
There is no explicit guidance in Ind AS 17 on accounting for modifications of operating leases by lessors. Where the modification of an operating lease does not result in the lease being reclassified as a finance lease, any changes to future lease payments are accounted for prospectively on a straight-line basis over the remaining revised lease term.

Ind AS 116 provides guidance on modifications of operating leases by lessors. The accounting requirements under Ind AS 116 are generally consistent with the previously developed practice for accounting for modifications of operating leases by lessors. Modifications to an operating lease should be accounted from the effective date of the modification, considering any prepaid or accrued lease payments relating to the original lease as part of the lease payments for the new lease (Ind AS 116 para 87). Ind AS 116 provides greater clarity as to the effective date of a modification and defines this as the date on which the parties agree to the modification.

Key takeaway

Ind AS 116 does contain changes that have an accounting impact on lessors. In particular, lessors should be aware of the new guidance on the definition of a lease, lease term and lease payment, separation of components, subleases and the accounting for sale and leaseback transactions.

From a commercial point of view, changes in lessee accounting could also impact lease negotiations, given that property leases will often result in the recognition of significant assets and liabilities for many lessees. The focus in negotiations might no longer be on whether the contract would qualify as an operating or a finance lease, but instead on whether the definition of a lease is met at all. Other matters might include variable lease payments which could be excluded from the lease liability, or inclusion of termination options which might minimise the lease term. As such, the new standard might have an impact that extends beyond the accounting implications. The lessor's business processes, systems and controls are also expected to be impacted by the new standard.



Keeping up with key audit matters

Introduction

The new standard on auditing (SA) 701, **Communicating Key Audit Matters in the Independent Auditor's Report**, is effective for audits of financial statements for periods beginning on or after 1 April 2018. SA 701 is mandatory in the case of audits of listed entities and casts a new reporting requirement on auditors of listed entities to communicate KAM in their audit reports.

In this article, we have covered some frequently asked questions (FAQs) about KAM reporting.

What is the purpose for bringing in the requirement for reporting KAM in the auditor's report?

The purpose of communicating key audit matters is to:

i. Enhance the communicative value of the auditor's report by providing greater transparency about the audit that was performed.

ii. Provide additional information to intended users of the financial statements to assist them in understanding those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period.

iii. Assist intended users in understanding the entity and areas of significant management judgment in the audited financial statements.

Does SA 701 apply to unlisted entities?

SA 701 is mandatorily applicable to audits of a complete set of general purpose financial statements of listed entities for periods beginning on or after 1 April 2018.

SA 701 applies to audits of unlisted entities under the following circumstances:

i. When the auditor decides to communicate KAM in the auditor's report, or

ii. When the auditor is required by law or regulation to communicate KAM in the auditor's report. For example, it can be given by the auditor on voluntary basis when communication of KAM will:

- Promote consistency and comparability in auditor's reporting; and
- Assist intended users of the financial statements in understanding those matters that, in the auditor's professional judgement, were of most significance in the audit of financial statements of the current period.

Since SA 701 applies to audits of listed entities, the status of listing is to be determined as of which date?

SA 701 would apply to an entity whose securities (shares, scrips, stocks, bonds, debentures) are listed on any stock exchange in India or outside India as on the reporting date (balance sheet date). SA 701 is not applicable to entities which are in the process of getting listed as at the reporting date.

Can KAM be different for different years?

Identification of a KAM is a matter of professional judgement. Although it is possible for KAM to be different in different years, given that identification of key audit matters is a result of the risk assessment procedures adopted by an auditor, it may be unlikely that KAM would be entirely different in different years.

Is it possible for different entities in the same industry to have different KAM communicated by their auditors?

Yes, it is possible for different entities in the same industry and those who have a similar type of business to have different KAMs that are communicated by their auditors.

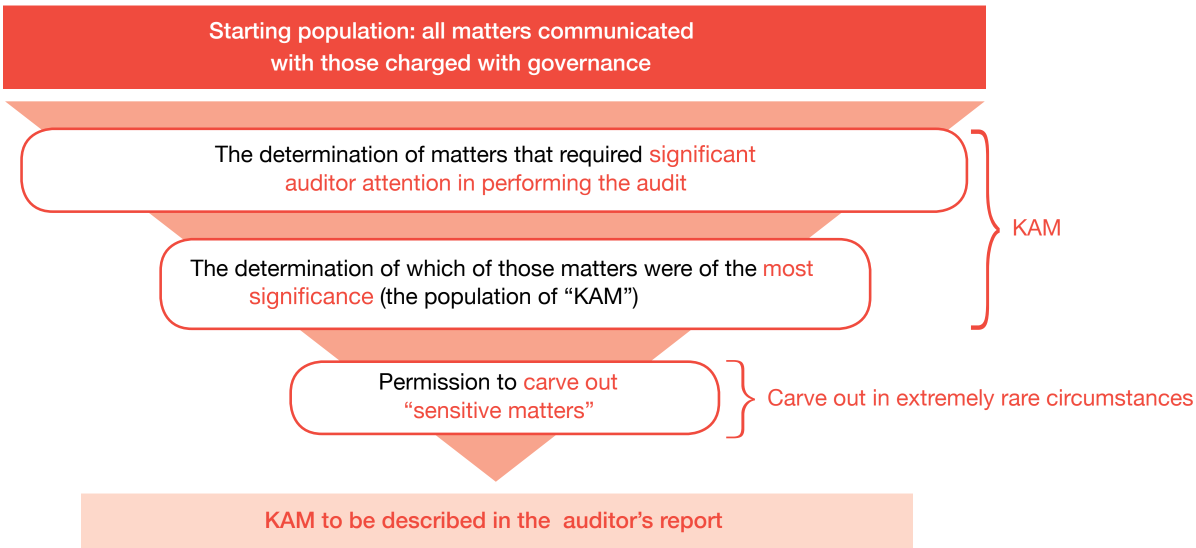
The matters that qualify for communication as KAM are largely driven by the risk assessment process of the auditor and entity-specific conditions and circumstances.

However, certain matters may be determined as KAM in a particular industry across a number of entities due to the circumstances of the industry or the underlying complexity in financial reporting. In describing why the auditor considered the matter to be one of most significance, it may be useful for the auditor to highlight aspects specific to the entity (e.g. circumstances that affected the underlying judgments made in the financial statements of the current period) in order to make the description more relevant for intended users. This may also be important in describing a KAM that recurs over periods.

Should all matters communicated to those charged with governance be KAM?

No, matters that are communicated to those charged with governance act as a starting point in determining KAM. The decision-making process in determining KAM is designed to select a small number of matters from the matters communicated with those charged with governance, based on the auditor's judgment about which matters were of most significance in the audit of the financial statements of the current period.

Selecting KAM



On determination of a matter to be a KAM, how should the same be described in the auditor's report?

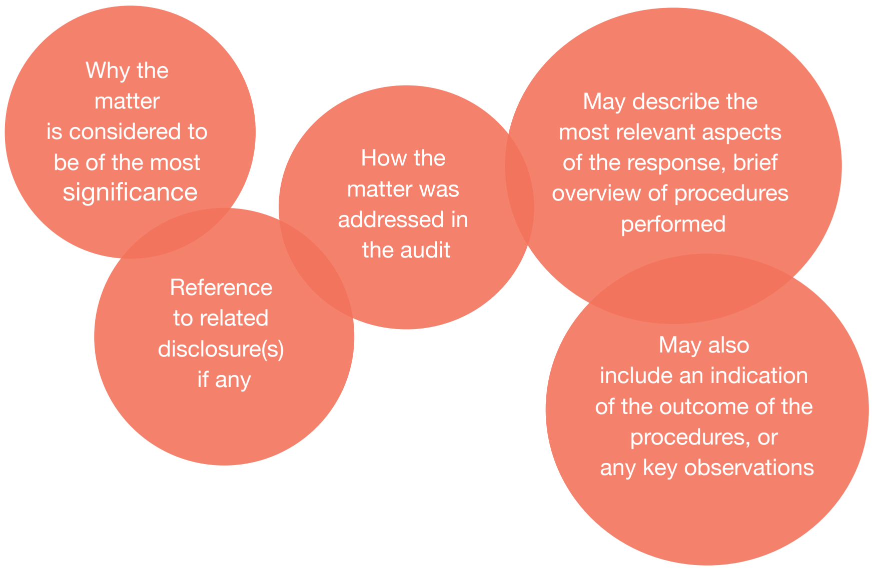
The description of each KAM in the KAM section of the auditor's report shall include a reference to the related disclosure(s), if any, in the financial statements and shall address:

- Why the matter was considered to be one of most significance in the audit and therefore determined to be a KAM; and
- How the matter was addressed in the audit.

The adequacy of the description of a KAM is a matter of professional judgment. The description of a KAM is intended to provide a succinct and balanced explanation to enable intended users to understand why the matter was one of most significance in the audit and how the matter was addressed in the audit. Limiting the use of highly technical auditing terms also helps to enable intended users who do not have a reasonable knowledge of auditing to understand the basis for the auditor's focus on particular matters during the audit. The nature and extent of information provided by the auditor are intended to be balanced in the context of the responsibilities of the respective parties (i.e. for the auditor to provide useful information in a concise and understandable form while not inappropriately being the provider of original information about the entity).

Original information is any information about the entity that has not otherwise been made publicly available by the entity (e.g. has not been included in the financial statements or other information available at the date of the auditor's report, or addressed in other oral or written communication by management or those charged with governance, such as a preliminary announcement of financial information or investor briefings).

What descriptions of KAM will include



Is there a threshold for the number of KAM that need to be communicated by the auditor?

No threshold has been prescribed in SA 701. It is a matter of professional judgement of the auditor.

The number of KAM to be included in the auditor's report may be affected by the size and complexity of the entity, the nature of its business and environment, and the facts and circumstances of the audit engagement.

In general, the greater the number of matters initially determined to be KAM, the more the auditor may need to reconsider whether each of these matters meets the definition of a KAM. Lengthy lists of KAM may be contrary to the notion of such matters being those of most significance in the audit.

Can there be circumstances in which a matter determined to be a KAM is not communicated in the auditor's report?

Yes, under the following circumstances, a matter determined to be a KAM is not communicated in the auditor's report:

- Law or regulation precludes public disclosure about the matter;
- In extremely rare circumstances, the auditor determines that the matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication. This shall not apply if the entity has publicly disclosed information about the matter.

When an auditor decides to omit a matter from the auditor's report, the auditor may obtain a written representation from management, and when appropriate, those charged with governance, as to why public disclosure about the matter is not appropriate, including management's view about the significance of the adverse consequences that may arise as a result of such communication.

Should the KAM be provided in any specific order?

There is no specific order in which KAM are required to be communicated in the auditor's report.

The order of presentation of individual matters within the KAM section is a matter of auditor's professional judgment.

For example, such information may be organised in order of relative importance, based on the auditor's judgement, or may correspond to the manner in which matters are disclosed in the financial statements.

Is providing KAM in an auditor's report in the nature of providing a separate opinion on individual matters reported as KAM?

No, communicating KAM in the auditor's report is in the context of the auditor having formed an opinion on the financial statements as a whole.

Further, communicating KAM is not:

- A substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation;
- A substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705 (Revised), **Modifications to the Opinion in the Independent Auditor's Report**. SA 705 (Revised) defines modified opinion as a qualified opinion, an adverse opinion or a disclaimer of opinion on the financial statements;
- A substitute for reporting in accordance with SA SA 570 (Revised), **Going Concern** when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern; or
- A separate opinion on individual matters.

Does the auditor have an obligation to communicate to those charged with governance the KAM that have been identified for communication in the auditor's report?

The auditor is required to communicate with those charged with governance:

- Those matters the auditor has determined to be the KAM; or
- If applicable, depending on the facts and circumstances of the entity and the audit, the auditor's determination that there are no KAM to communicate in the auditor's report.

There could be situations where there are no KAM to be communicated. The determination of KAM involves making a judgment about the relative importance of matters that require significant auditor attention. Therefore, it may be rare that the auditor of a complete set of general purpose financial statements of a listed entity would not determine at least one KAM from the matters communicated with those charged with governance to be communicated in the auditor's report. However, in certain limited circumstances (e.g. for a listed entity that has very limited operations), the auditor may determine that there are no KAM for communication. This needs to be communicated to those charged with governance and included in the auditor's report.

Final thoughts

Reporting of KAM is an opportunity for the auditing profession to improve the relevance of their audits to the benefit of companies and their stakeholders. Auditors need to work closely with their clients and embrace the challenges of the new reporting requirements, solicit and respond to feedback from stakeholders and continue to deliver informative and insightful auditor's reports to reflect the spirit of the audit reporting reform.

Companies (Amendment) Ordinance, 2019

Introduction

The Companies (Amendment) Ordinance, 2019 (the Ordinance), received the President of India's assent, bringing into force further amendments to certain provisions of the Companies Act, 2013 (the Act), with effect from 2 November 2018. The Ordinance promulgated is based on the recommendations made by the Committee appointed by the government to review offences under the Act.

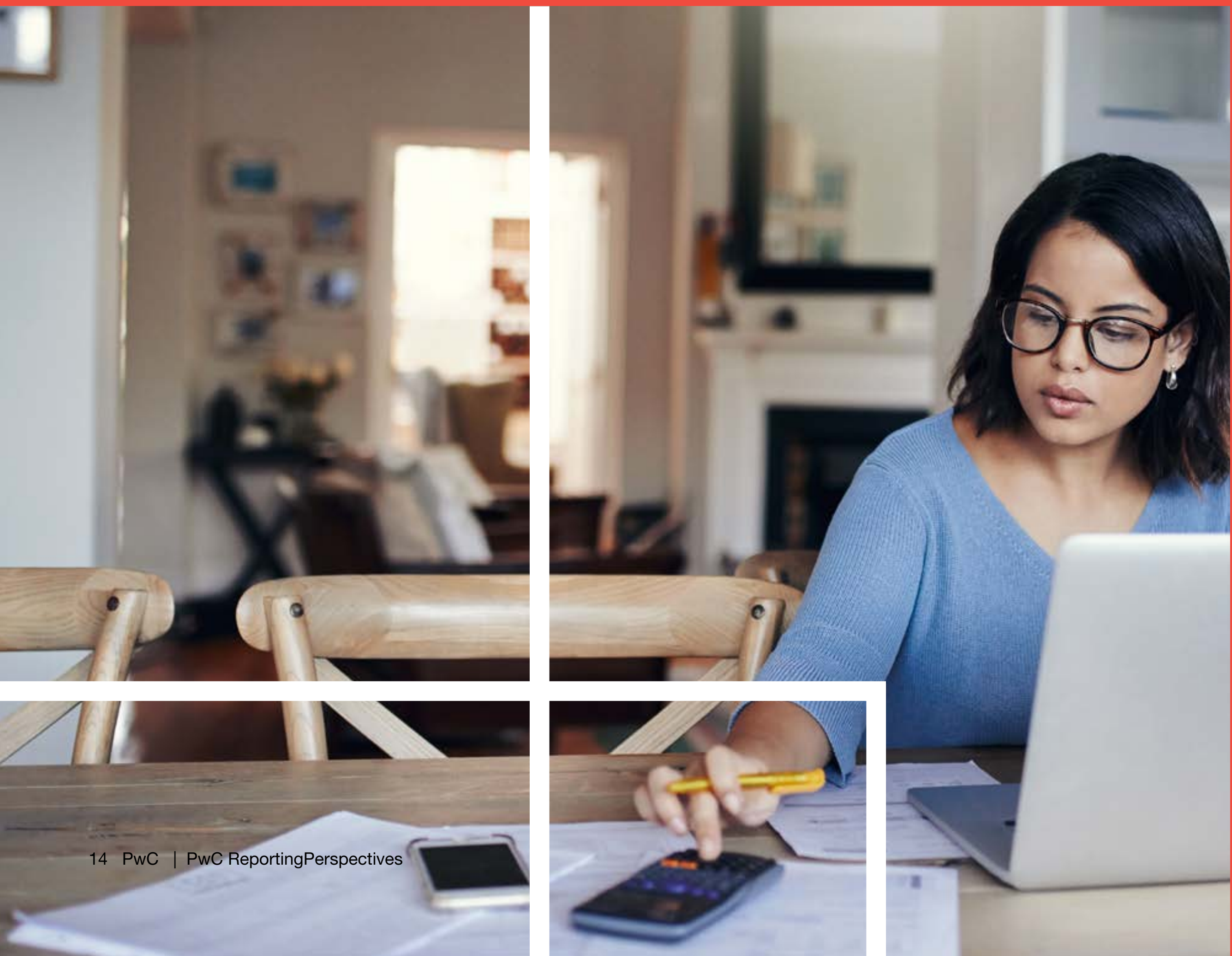
The twin objectives of the Ordinance are the promotion of ease of doing business along with better corporate compliance. The key aims of the amendments are as follows:

- Recategorisation of certain offences, which are in the category of compoundable offences to an in-house adjudication framework, wherein defaults would be subject to the penalty levied by an adjudicating officer;
- Instituting a transparent and technology driven in-house adjudication mechanism on an online platform and publication of the orders on the website;
- De-clogging the National Company Law Tribunal (NCLT) by introducing certain amendments and enhancing the role of the Regional Director (RD);
- Tackling the larger issue of 'shell companies', enhancing accountability with respect to filing documents related to charges, non-maintenance of registered office, etc.

The key amendments are analysed below.

Definition of financial year

As per the existing provisions, the application for adopting a different financial year was to be made to the tribunal. The Ordinance now requires the application to be made to the Central Government.



Re-introduction of commencement of business declaration

- Companies incorporated after 2 November 2018 with share capital shall not commence any business or exercise any borrowing power unless:
  - A declaration is filed by a director within 180 days of the date of incorporation, confirming that every subscriber has paid up the value of shares agreed to be taken;
  - The Company has filed the verification of its registered office with the registrar.
- In case no declaration is filed within 180 days of incorporation and the registrar has reasonable cause to believe that the company is not conducting any business or operations, the registrar may initiate the removal of its name from the register of companies.

Physical verification of registered office

The registrar has the power to conduct physical verification of the registered office and initiate strike-off of the company if there is reasonable cause to believe that the company is not conducting any business or operations.

Registration of charges

The Ordinance has significantly reduced the timeline for registration of charges.

- In case of charges created before 2 November 2018, the registrar may—on application by the company—allow registration of the charge within a period of 300 days of such charge creation. If the registration is not made within 300 days, the registration of the charge can be made within six months from the date of commencement of the Ordinance.

- In case of charges created after 2 November 2018 the registrar may—on application by the company—allow registration of the charge within 60 days of such charge creation (existing provisions provided 270 days on payment of an additional fee). If the charge is not created within the aforesaid period, the registration shall be made within an additional period of 60 days after payment of such ad-valorem fees.

Significant beneficial ownership disclosure

- Considering the importance of the disclosure, the punishment for non-compliance is enhanced to the effect that contravention is punishable with fine or imprisonment (up to one year) or both, instead of being punishable with only a fine.

- In case the rights of a shareholder have been suspended by the NCLT for not providing disclosure, the company or person aggrieved by its order may make an application to it for relaxation or lifting of restrictions within a period of one year from the date of order.

Disqualifications from appointment of directors

A new clause (i) has been inserted after clause (h) in section 164(1) of the Act, whereby a person shall be subject to disqualification if he/she accepts directorships exceeding the maximum number of directorships provided in section 165 of the Act.

Recategorisation of certain offences

Certain offences have been recategorised as defaults carrying civil liabilities to bring them under an in-house adjudication mechanism. The key provisions amended are as follows:

- Issue of shares at a discount
- Non-filing of annual return within the due date,
- Failure/delay in filing financial statements,
- Contraventions related to Director Identification Number,
- Failure/delay in filing certain resolutions,
- Failure/delay in filing statement by the auditor after resignation,
- Managerial remuneration,
- Appointment of key management personnel in certain class of companies.

De-clogging of NCLT

- Offences (with only fine or imprisonment or fine) where the maximum amount of fine is up to INR 2.5 million will be compounded by the RD. The earlier limit was up to INR 0.5 million only, and any matter beyond such limit had to be compounded with the NCLT.

- The applications for change of financial year and conversion of a company from public to private are now to be made to the Central Government instead of the NCLT.

- Pending applications with the NCLT submitted prior to 2 November 2018 in case of the above matters will be dealt with by the NCLT.

Key takeaway

The Ordinance provides much-needed relief to corporates and further promotes the Government of India’s intent to promote ease of doing business.

Amendments to IFRS 3 – definition of a business

Introduction

IFRS 3 establishes different accounting requirements for a business combination as opposed to the acquisition of an asset or a group of assets that does not constitute a business. Business combinations are accounted for by applying the acquisition method, which, among other things, may give rise to goodwill. In contrast, when accounting for asset acquisitions, the acquirer allocates the transaction price to the individual identifiable assets acquired and liabilities assumed on the basis of their relative fair values and no goodwill is recognised. Therefore, whether or not an acquired set of activities and assets is a business is a key consideration in determining how the transaction should be accounted for.

Prior to the amendments, IFRS 3 stated that a business consists of inputs and processes applied to those inputs that have the ability to create outputs. Although businesses usually have outputs, outputs are not necessarily required for an integrated set to qualify as a business. According to feedback received by the IASB, application of the current guidance is commonly thought to be too complex, and it results in too many transactions qualifying as business combinations.

To address those concerns, the IASB issued **Definition of a Business (Amendments to IFRS 3)** on 22 October 2018, aimed at resolving the difficulties that arise when an entity determines whether it has acquired a business or a group of assets. The amendments are effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2020.

New guidance

To be considered a business, an acquisition would have to include an input and a substantive process that together significantly contribute to the ability to create outputs. The new guidance provides a framework to evaluate when an input and a substantive process are present (including for early stage companies that have not generated outputs). To be a business without outputs, there will now need to be an organised workforce.

If a set of activities and assets does not have outputs at the acquisition date, an acquired process (or group of processes) shall be considered substantive only if:

a. it is critical to the ability to develop or convert an acquired input or inputs into outputs; and
b. the inputs acquired include both an organised workforce that has the necessary skills, knowledge, or experience to perform that process (or group of processes) and other inputs that the organised workforce could develop or convert into outputs. Those other inputs could include:
   i. intellectual property that could be used to develop a good or service;
   ii. other economic resources that could be developed to create outputs; or
   iii. rights to obtain access to necessary materials or rights that enable the creation of future outputs.

Examples of the inputs mentioned in subparagraphs (b)(i)–(iii) include technology, in-process research and development projects, real estate and mineral interests. (Paragraph B12B of IFRS 3).

If a set of activities and assets has outputs at the acquisition date, an acquired process (or group of processes) shall be considered substantive if, when applied to an acquired input or inputs, it:

a. is critical to the ability to continue producing outputs, and the inputs acquired include an organised workforce with the necessary skills, knowledge, or experience to perform that process (or group of processes);

   or

b. significantly contributes to the ability to continue producing outputs and:
   I. is considered unique or scarce; or
   II. cannot be replaced without significant cost, effort, or delay in the ability to continue producing outputs.
   (Paragraph B12C of IFRS 3)

The definition of the term 'outputs' is narrowed to focus on goods and services provided to customers, generating investment income and other income, and it excludes returns in the form of lower costs and other economic benefits.

It is also no longer necessary to assess whether market participants are capable of replacing missing elements or integrating the acquired activities and assets.

An entity can apply a 'concentration test' that, if met, eliminates the need for further assessment. Under this optional test, where substantially all of the fair value of gross assets acquired is concentrated in a single asset (or a group of similar assets), the assets acquired would not represent a business.

When assessing whether assets are similar, an entity shall consider the nature of each single identifiable asset and the risks associated with managing and creating outputs from the assets (that is, the risk characteristics).

If a tangible asset is attached to, and cannot be physically removed and used separately from, another tangible asset, without incurring significant cost, or significant diminution in utility or fair value to either asset (for example, land and buildings), those assets shall be considered a single identifiable asset.

Example—acquisition of real estate

Background

An entity (Purchaser) purchases a portfolio of 10 single-family homes that each have an in-place lease. The fair value of the consideration paid is equal to the aggregate fair value of the 10 single-family homes acquired. Each single-family home includes the land, building and property improvements. Each home has a different floor area and interior design. The 10 single-family homes are located in the same area and the classes of customers (e.g. tenants) are similar. The risks associated with operating in the real estate market of the homes acquired are not significantly different. No employees, other assets, processes or other activities are transferred.

Scenario 1—Application of requirements

The Purchaser elects to apply the optional concentration test set out in IFRS 3 and concludes that:

a. each single-family home is considered a single identifiable asset for the following reasons:

i. the building and property improvements are attached to the land and cannot be removed without incurring significant cost; and

ii. the building and the in-place lease are considered a single identifiable asset, because they would be recognised and measured as a single identifiable asset in a business combination.

b. the group of 10 single-family homes is a group of similar identifiable assets because the assets (all single-family homes) are similar in nature and the risks associated with managing and creating outputs are notsignificantly different. This is because the types of homes and classes of customers are not significantly different;

c. consequently, substantially all of the fair value of the gross assets acquired is concentrated in a group of similar identifiable assets.

Therefore, the Purchaser concludes that the acquired set of activities and assets is not a business.

Scenario 2—Background

Assume the same facts as in Scenario 1, except that the Purchaser also purchases a multi-tenant corporate office park with six 10-storey office buildings that are fully leased. The additional set of activities and assets acquired includes the land, buildings, leases and contracts for outsourced cleaning, security and maintenance. No employees, other assets, other processes or other activities are transferred. The aggregate fair value associated with the office park is similar to the aggregate fair value associated with the 10 single-family homes. The processes performed through the contracts for outsourced cleaning and security are ancillary or minor within the context of all the processes required to create outputs.

Scenario 2—Application of requirements

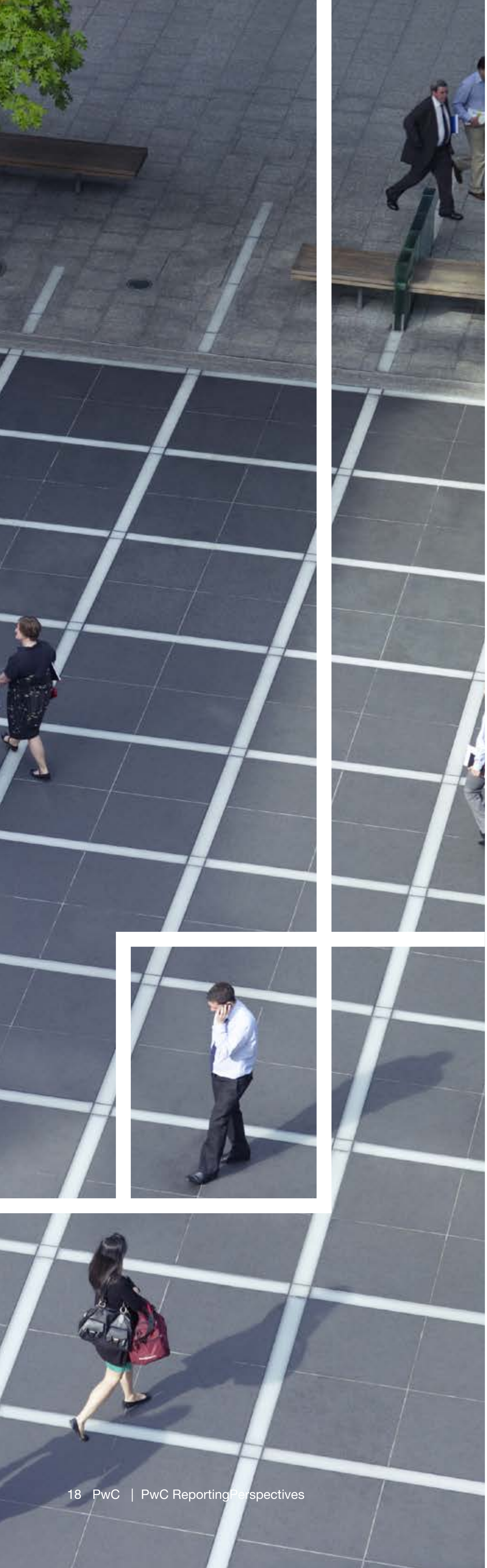
The Purchaser elects to apply the optional concentration test set and concludes that the single-family homes and the office park are not similar identifiable assets, because the single-family homes and the office park differ significantly in the risks associated with operating the assets, obtaining tenants and managing tenants. In particular, the scale of operations and risks associated with the two classes of customers are significantly different. Consequently, the fair value of the gross assets acquired is not substantially all concentrated in a group of similar identifiable assets, because the fair value of the office park is similar to the aggregate fair value of the 10 single-family homes. Thus, the Purchaser assesses whether the set meets the minimum requirements to be considered a business.

The set of activities and assets has outputs because it generates revenue through the in-place leases. Consequently, the Purchaser applies the criteria in paragraph B12C of IFRS 3 discussed above to determine whether any processes acquired are substantive.

The Purchaser concludes that the criterion in paragraph B12C(a) of IFRS 3 is not met because:

a. the set does not include an organised workforce; and

b. the Purchaser considers that the processes performed by the outsourced cleaning, security and maintenance personnel (the only processes acquired) are ancillary or minor within the context of all the processes required to create outputs and, therefore, are not critical to the ability to continue producing outputs.



After considering the only processes acquired, those performed by the outsourced cleaning, security and maintenance personnel, the Purchaser also concludes that the criteria in paragraph B12C(b) of IFRS 3 are not met. Either of the following reasons justifies that conclusion:

a. the processes do not significantly contribute to the ability to continue producing outputs;
b. the processes are readily accessible in the marketplace. Thus, they are not unique or scarce. In addition, they could be replaced without significant cost, effort, or delay in the ability to continue producing outputs.

Because none of the criteria in paragraph B12C of IFRS 3 are met, the Purchaser concludes that the acquired set of activities and assets is not a business.

Scenario 3—Background

Assume the same facts as in Scenario 2, except that the acquired set of activities and assets also includes the employees responsible for leasing, tenant management, and managing and supervising all operational processes.

Scenario 3—Application of requirements

The Purchaser elects not to apply the optional concentration test and therefore assesses whether the set meets the minimum requirements to be considered a business.

The acquired set of activities and assets has outputs because it generates revenue through the in-place leases. Consequently, the Purchaser applies the criteria in paragraph B12C of IFRS 3.

The Purchaser concludes that the criterion in paragraph B12C(a) of IFRS 3 is met because the set includes an organised workforce with the necessary skills, knowledge or experience to perform processes (i.e. leasing, tenant management, and managing and supervising the operational processes) that are substantive because they are critical to the ability to continue producing outputs when applied to the acquired inputs (i.e. the land, buildings and in-place leases). Consequently, the Purchaser concludes that the acquired set of activities and assets is a business.

Key takeaway

The changes to the definition of a business will likely result in more acquisitions being accounted for as asset acquisitions across industries, particularly real estate, pharmaceutical, and oil and gas. Application of the changes would also affect the accounting for disposal transactions. Differences in accounting between business combinations and asset acquisitions include, among other things, the recognition of goodwill, recognition and measurement of contingent consideration, accounting for transaction costs, and deferred tax accounting.

Entities shall apply these amendments to business combinations for which the acquisition date is on or after the beginning of the first annual reporting periods beginning on or after 1 January 2020 and to asset acquisitions that occur on or after the beginning of that period. Early application is permitted.

Recent technical updates

Institute of Chartered Accountants of India (ICAI)

Expert Advisory Committee (EAC) opinions issued by the ICAI:

1. **Treatment of 'prepayment penalty' incurred for foreclosure of existing loan and availing new loan/borrowings**

Facts and query:

The company is engaged in the business of development of a retail mall and residential real estate project. It had constructed a retail mall in Coimbatore by availing a project finance term loan from banks. The term loan had an original tenure of 10 years and carried an interest of 13.5% per annum. On completion of the mall, the loan has a remaining tenure of six-and-a-half years. Once the mall is constructed and leasing is done by giving shops on rent, the project refinance term loan is refinanced by taking a lease rent discounting (LRD) term loan from banks. The project finance term loan carries an interest @13.5% per annum, while the LRD loan carries interest of 9% per annum. The objective of the fresh loan is to refinance the high-cost current project finance term loan. As per sanction terms with the existing bank, a prepayment penalty of 1%–2% is applicable on foreclosure of loan.

What should be the accounting treatment of the 'prepayment penalty' incurred for foreclosure of the existing loan and availing a new loan/borrowing?

EAC opinion:

Transaction costs are the incremental costs which are directly attributable to the acquisition or disposal of a financial liability. At the time of initial recognition, financial liability shall include only the transaction costs that are directly attributable to the acquisition or issue of the new financial liability and not the transaction cost of the disposal of the existing financial liability. The Committee was of the view that prepayment penalty is the transaction cost of the disposal of the existing financial liability (loan) which is payable to the existing loan provider rather than the incremental cost of acquisition or issue of the new financial liability (new loan) from a different new bank. Further, such a penalty is incurred to extinguish the existing liability and to get the benefits due to lower cost liability (loan) and not for acquiring the new financial liability (loan). Therefore, such penalty cannot be treated as directly attributable to the acquisition of the new financial liability. Accordingly, the Committee opined that prepayment penalty in the extant case cannot be considered as transaction cost of the new loan; rather, it should be treated as the transaction cost of the extinguishment of the existing loan, which, in accordance with paragraph 5.7.2 of Ind AS 109, **Financial Instruments**, should be recognised as part of the gain or loss on extinguishment/derecognition of the old loan in the statement of profit and loss.

2. **Treatment of disputed amount (principal and interest) in respect of cases pending before various regulatory authorities**

Facts and query:

A company has legal cases pending before various authorities, which are disclosed as contingent liabilities in the financial statements. The company has not disclosed the interest payable amount on the disputed amount as contingent liabilities. The querist sought the opinion of the EAC as to whether (i) the amount of contingent liabilities is correct considering that appeal is pending before various judicial authorities; (ii) (a) whether the interest liability is required to be computed and disclosed as contingent liability as on balance sheet date, although there is no demand for interest; or (b) even if there is no demand for interest on the company, whether the fact that the contingent liabilities amount does not include interest is required to be disclosed; or (c) None of above (ii) (a) or (ii) (b) is required to be disclosed.

EAC opinion:

i. The company should, based on all the available evidence, assess whether there is a present or possible obligation towards the demand raised by various judicial authorities. If it is considered probable that a present obligation exists at the balance sheet date and the said obligation will be settled, of which a reliable estimate can be made, the company should recognise a provision for the demand raised. However, if it is considered that the recognition criteria for making a provision are not met, then the company should disclose the same as a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote.

ii. Further, the EAC was of the opinion that based on all facts and circumstances available on the balance sheet date, such as the past decisions taken by the taxation and judicial authorities in similar cases, it should be decided by the management of the company as to whether the interest liability that may arise in respect of cases pending before various authorities is required to be computed and disclosed as a contingent liability or not.

3. Provision for un-encashable portion of half pay leave (HPL)

Facts and query:

A company provides HPL to employees. HPLs are un-encashable during the service period. However, HPLs are encashable on superannuation only to the extent of the privilege leaves to the credit of executive employees falling short of the maximum limit of 300 days. The benefit of HPL encashment on superannuation has not been extended to non-executives employees. The querist has sought the opinion of the EAC as to whether the provision for un-encashable HPLs (whether executive or non-executive employees) should be created similar to the encashable portion as part of the cost of services rendered during the period in which the service was rendered which resulted in the entitlement.

EAC opinion:

The Committee opined that irrespective of whether un-encashable accumulating HPLs are classified as ‘short-term employee benefits’ or as ‘other long-term employee benefits’, a liability on account of these should be provided as per the requirements of AS 15, **Employee Benefits/**Ind AS 19**, Employee Benefits**, which should be reviewed at each reporting date to recognise the effects of changes in estimates.

Ind AS Transition Facilitation Group (ITFG) Bulletin 17

The Ind AS Implementation Group of the ICAI constituted the ITFG to address issues faced by preparers, users and other stakeholders on applicability and implementation of Ind AS. The ITFG issues clarifications in the form of periodic bulletins.

ITFG recently issued its bulletin no. 17. The clarifications from the bulletin are summarised below:

1. The MCA notified the Companies (Indian Accounting Standards) Second Amendment Rules, 2018 (the ‘Rules’), on 20 September 2018. The Rules are effective for annual periods beginning on or after 1 April 2018. Among other matters, the Rules amended Ind AS 20, **Accounting for Government Grants and Disclosure of Government Assistance**, to allow entities the option to record non-monetary government grants at a nominal amount. Prior to the Rules, Ind AS 20 required non-monetary government grants (both grant and asset) to be accounted for at fair value only. Accordingly, an entity transitioning to Ind AS in FY 2018–2019, i.e. a first-time adopter of Ind AS, which had accounted the non-monetary government grant at nominal amount under previous Indian GAAP, can measure such non-monetary government grant on the date of transition to Ind AS at nominal amount or fair value. For an entity which is not a first-time adopter of Ind AS, a change in accounting of non-monetary government grant from fair value to nominal amount would be a voluntarily change in accounting policy since the Rules do not contain any transition provision. As per Ind AS 8, **Accounting Policies, Changes in Accounting Estimates and Errors**, such voluntary change in accounting policy is only permitted when the change results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity’s financial position, financial performance or cash flows.
2. Where preference shares issued by an entity are classified as liability, dividend payable thereon is in the nature of interest and should be recognised in profit or loss in accordance with the effective interest method. The dividend distribution tax (DDT) payable on such preference dividend should be considered in determination of effective interest rate (EIR) of the preference shares.
3. Benefit received by a software technology park (STP)/special economic zone (SEZ) unit in the nature of exemption from payment of taxes and duties levied by the government on import/export of goods upon fulfilment of certain conditions is a government grant. The classification of such government grant as ‘asset’ or ‘income’ related government grant will require exercise of judgement and examination of the facts, objective and conditions attached to the scheme of grant. The purpose of the grant and the costs the grant are intended to compensate would also need to be assessed.
4. Subsequent measurement of a financial asset (debt instrument) at amortised cost, fair value through other comprehensive income (FVOCI) or fair value through profit or loss (FVTPL) depends upon the entity’s business model for managing the financial asset and the contractual cash flows characteristics of the financial asset. Income from a financial asset subsequently measured at amortised cost or FVOCI is recognised using the EIR method, irrespective of the legal form of income (interest or dividend). Depending upon the business model and the contractual cash flows characteristics test, if such preference shares are subsequently measured at amortised cost or FVOCI, then dividend income on such preference shares is recognised using the EIR method.
5. When an investor acquires control or joint control or significant influence over an investee, Ind AS 103, **Business Combinations**, or Ind AS 28, **Investment in Associates and Joint Ventures**, requires goodwill or bargain purchase gain/capital reserve to be identified

based on the fair value (and not book value) of the identifiable assets and liabilities of the investee as at the acquisition date. The fair value of the identifiable assets and liabilities of the investee on acquisition date is the cost of such assets or liabilities for the investor. Accordingly, appropriate adjustment arising out of fair valuation of assets/liabilities impacting profit or loss of the investee should be made by investor. For example, depreciation of investment property of investee shall be based on its fair value at acquisition date. The above requirement of Ind AS 103/Ind AS 28 to measure identifiable assets and liabilities of the investee at fair value in the financial statements of the investor do not contradict with other Ind AS such as Ind AS 40 which require cost-based measurement in the financial statements of the investee.

6. Supply of electricity by subsidiary (sole distributor of electricity in a specific geographical area) to parent is a 'related part transaction' that would attract the disclosures of Ind AS 24, **Related Party Disclosures**. The disclosures of Ind AS 24 are required for such transaction, notwithstanding the fact that the parent is charged electricity tariffs as determined by an independent rate-setting authority, i.e. the terms of supply of electricity are at par with those applicable to other customers. Ind AS 24 does not exempt an entity from disclosing related party transactions merely because they have been carried out on arm's length basis. If the parent-subsidiary relationship did not exist and the only relationship between the entities was that of a supplier and a customer of electricity, then such parties are not considered as related parties as per Ind AS 24.

7. As per Ind AS 32, **Financial Instruments: Presentation**, a derivative is a financial liability if it will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. A derivative that will be settled by the issuer only by exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments is classified as equity. This is commonly referred to as the 'fixed for fixed' requirement. The term 'fixed amount of cash' refers to an amount of cash fixed in functional currency of the reporting entity. Since an amount fixed in a foreign currency has the potential to vary in terms of functional currency of the reporting entity due to exchange rate fluctuations, it does not represent 'a fixed amount of cash'. Ind AS 32 provides the following two exceptions to the 'fixed for fixed' requirement where the variation is due to foreign currency:

   I. Rights issue to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights issue pro rata to all of its existing owners of the same class of its own equity instruments.

   II. Equity conversion option embedded in a convertible bond denominated in foreign currency to acquire a fixed number of the entity's own equity instruments is an equity instrument if the exercise price is fixed in any currency. This exception is a carveout from IAS 32, **Financial Instruments: Presentation,** issued by the IASB. This exception cannot be applied by analogy to equity conversion options embedded in other types of financial instruments denominated in a foreign currency, such as preference shares.

8. An entity issues preference shares denominated in its own functional currency. The preference shares carry discretionary non-cumulative dividend of 12% per annum and are convertible at the option of the holder at any time during the term into a fixed number of equity shares of the entity. The holder of the preference shares also has an option to put the preference shares back to the entity at any time for the par amount. Accordingly, the preference shares are a compound financial instrument containing both a liability component (representing the redemption feature in cash) and equity component (representing the discretionary dividend and holder's equity conversion option) from the issuer's perspective. Ind AS 113, **Fair Value Measurement**, states that fair value of a financial liability with a demand feature (e.g. a demand deposit) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid. Since the entity has a contractual obligation to pay the par amount at any point in time at the option of the holder, preference shares represent a financial liability with a demand feature. Accordingly, the entire issue proceeds of the preference shares are allocated to the liability component and no amount is assigned to equity component.

9. Presentation of interest payable on delayed payment of taxes levied by the local authority depends upon whether the interest is compensatory in nature for time value of money or penal in nature. This requires exercise of judgement based on evaluation of facts of the case. If it is concluded that interest is compensatory in nature, then it shall be classified as 'finance cost'. If interest is penal in nature, then it shall be classified as 'other expenses'.

10. Under the Income-tax Act, 1961, the conversion of capital asset into stock-in-trade is taxable in the year of sale of stock-in-trade and not in the year of conversion. Accordingly, no current tax liability arises in the year of conversion. A deductible temporary difference exists where the asset is carried at historical cost in the books but its tax base is indexed i.e. adjusted for inflation. Deferred tax asset on such deductible temporary difference should be recognised, provided the recognition criteria of Ind AS 12, **Income Taxes** is met. The difference between the asset's indexed cost and its fair value on the date of conversion does not meet the definition of temporary difference as per Ind AS 12 and accordingly, no deferred tax has to be recognised for such difference.

Educational material on Ind AS 110, Consolidated Financial Statements

Ind AS 110 establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. The standard defines the principle of control, sets out how to apply the principle of control and explains the accounting requirements for preparing consolidated financial statements. The Ind AS Implementation Group of the ICAI has issued educational material on Ind AS 110. This educational material contains a summary of Ind AS 110 and discusses the key requirements of the standard, FAQs and illustrations covering the issues, which are expected to be encountered frequently while implementing the standard.

Implementation Guide on Resignation/ Withdrawal from an Engagement to Perform Audit of Financial Statements

The Auditing and Assurance Standards Board (AASB) of the ICAI has issued Implementation Guide Resignation/ Withdrawal from an Engagement to Perform Audit of Financial Statement. The implementation guide contains guidance on various aspects of auditors' resignation like circumstances leading to withdrawal/resignation, procedure to be followed by auditors in case of resignation, auditor's responsibilities and professional obligations to be complied with by auditors. This implementation guide is applicable in case of audits of all listed entities. Further, in the case of audits of banks, insurance companies and other corporate entities, the guidance given in this implementation guide should be followed, as applicable.

Standards on Internal Audits (SIA)

ICAI has issued the following SIA:

I. SIA 210, **Managing the Internal Audit Function**
II. SIA 220, **Conducting Overall Internal Audit Planning**
III. SIA 310, **Planning the Internal Audit Assignment**
IV. SIA 320, **Internal Audit Evidence**
V. SIA 330, **Internal Audit Documentation**

The ICAI also issued a preface to the framework and SIA, framework governing internal audits and basic principles of internal audit.

The SIAs are a set of minimum requirements that apply to all members of the ICAI while performing internal audit of any entity or body corporate. The SIAs are applicable for all internal audits beginning on or after a date to be notified by the Council of the Institute.

Ministry of Corporate Affairs (MCA)

Notification of sub-sections of Section 132 of the Companies Act, 2013 – Constitution of the National Financial Reporting Authority (NFRA)

The Central Government has set 24 October 2018 as the date on which sub-sections (2), (4), (5), (10), (13), (14) and (15) of section 132 of the Companies Act, 2013, shall come into force.

The notified sub-sections, inter-alia, deal with:

1. Making recommendations to the Central Government on the formulation and laying down of accounting and auditing policies and standards for adoption by companies or class of companies or their auditors, as the case may be.
2. Monitoring and enforcing compliance with accounting standards and auditing standards in such manner as may be prescribed.
3. Power to investigate into the matters of professional or other misconduct committed by any member or firm of chartered accountants, registered under the Chartered Accountants Act, 1949.
4. Books of account to be maintained by the NFRA, audit of accounts of the NFRA by the Comptroller and Auditor-General of India, preparation of annual report by the NFRA.

Securities and Exchange Board of India (SEBI)

Disclosures regarding commodity risks by listed entities (circular dated 15 November 2018)

Regulation 34(3) read with clause 9(n) of Part C of Schedule V of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (SEBI LODR Regulations), mandates listed entities to make disclosures regarding commodity price risk and hedging activities in the corporate governance report section of the annual report of a listed entity.

In order to benefit shareholders and bring further clarity in disclosures to be made in the annual reports by listed entities, the Corporate Governance Committee recommended certain disclosures. The recommendation of the Committee was accepted by the SEBI Board and accordingly, all listed entities shall make the necessary disclosures in the format as enclosed as part of the corporate governance report in the annual report under clause 9(n) of Part C of Schedule V of the SEBI LODR Regulations.

The disclosures, inter alia, deal with:

- Risk management policy of the listed entity with respect to commodities, including through hedging and exposure of the listed entity to commodity;
- Commodity risks faced by the entity throughout the year.

Disclosure of reasons for delay in submission of financial results by listed entities (circular dated 19 November 2018)

Regulation 33 of the SEBI LODR Regulations, inter alia, specifies timelines for submission of financial results by listed entities. Accordingly, the quarterly and annual financial results are to be submitted by listed entities to stock exchanges within 45/60 days from the end of the quarter/financial year. It is expected that the listed entities shall adhere to the aforesaid timelines for submission of financial results.

Wherever there were delays in submission of financial results by certain listed entities to the stock exchanges in the past, while the fact of delay was intimated by the listed entity, the reasons for the same were not disclosed/were not brought out clearly. In such cases, the investors were often left unaware about the reasons for such delays, which may have had an impact on their investment decision. Hence, the need for disclosure by listed entities of reasons for delay in submission of financial results arises.

Accordingly, if any listed entity does not submit its financial results in accordance with the timelines specified in Regulation 33 of SEBI LODR Regulations, the listed entity shall disclose detailed reasons for such delay to the stock exchanges within one working day of the due date of submission for the results as required under Regulation 33 of SEBI LODR Regulations. However, if the decision to delay the results was taken by the listed entity prior to the due date, the listed entity shall disclose detailed reasons for such delay to the stock exchanges within one working day of such decision.

Fund raising by issuance of Debt Securities by Large Entities (circular dated 26 November 2018)

With a view to operationalising the Union Budget announcement for 2018–19, which, inter alia, stated ‘SEBI will also consider mandating, beginning with large entities, to meet about one-fourth of their financing needs from the debt market’, SEBI came out with a discussion paper on 20 July 2018. Based on feedback received on the discussion paper and wider consultation with market participants, including entities, the detailed guidelines for operationalising the budget requirements have been issued by SEBI.

These inter alia include:

I. Applicability of framework: For the entities following April–March as their financial year (FY), the framework shall come into effect from 1 April 2019 and for the calendar year entities, the applicability will be from 1 January 2020. The framework shall be applicable for all listed entities (except for scheduled commercial banks) meeting prescribed criteria.

II. Disclosure requirements for large corporates: A listed entity, identified as a large corporate (LC) under the instant framework, shall make the following disclosures to the stock exchanges where its security(ies) are listed:
   i. Within 30 days from the beginning of the FY, disclose the fact that they are identified as an LC, in the format as provided in Annexure A.
   ii. Within 45 days of the end of the FY, the details of the incremental borrowings done during the FY, in the formats as provided in Annexure B1 and B2.

Such disclosures shall be certified both by the Company Secretary and the Chief Financial Officer of the LC and shall also form part of audited annual financial results of the entity.

Reserve Bank of India (RBI)

Micro, Small and Medium Enterprises (MSME) sector – Restructuring of Advances (Notification No dated 1 January 2019)

With a view to facilitate meaningful restructuring of MSME accounts (MSME as defined in the Micro, Small and Medium Enterprises Development [MSMED] Act, 2006) that have become stressed, it has been decided to permit a one-time restructuring of existing loans to MSMEs classified as ‘standard’ without a downgrade in the asset classification, subject to certain conditions. Banks and non-banking financial companies (NBFCs) shall make appropriate disclosures in their financial statements, under ‘Notes on Accounts’, relating to the MSME accounts restructured under these instructions in prescribed format.

Basel III Framework on Liquidity Standards - Liquidity Coverage Ratio (LCR), Facility to Avail Liquidity for Liquidity Coverage Ratio (FALLCR) against credit disbursed to Non-banking financial companies (NBFCs) and Housing Finance Companies (HFCs) (Circular dated 19 October 2018 and Notification dated 28 December 2018)

Banks have been permitted to reckon government securities as Level 1 high-quality liquid assets (HQLAs) under FALLCR within the mandatory statutory liquid ratio (SLR) requirement up to 0.5% of their net demand and time liabilities (NDTL) in respect of their incremental lending to NBFCs and HFCs after 19 October 2018. This facility is available up to 31 March 2019. Further, the single borrower limit for NBFCs (not financing infrastructure) has been increased from 10% to 15% of capital funds till 31 March 2019.

IASB: IFRS

Amendment to the definition of 'material'

On 31 October 2018, the IASB issued amendments to IAS 1, **Presentation of Financial Statements**, and IAS 8, **Accounting Policies, Changes in Accounting Estimates and Errors**, and consequential amendments to other IFRS:

i. use a consistent definition of materiality throughout IFRS and the Conceptual Framework for Financial Reporting;

ii. clarify the explanation of the definition of material; and

iii. incorporate some of the guidance in IAS 1 about immaterial information.

The amended definition is:

"Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity."

The amendment clarifies that the reference to obscuring information addresses situations in which the effect is similar to omitting or misstating that information. It also states that an entity assesses materiality in the context of the financial statements as a whole.

The amendment also clarifies the meaning of 'primary users of general purpose financial statements' to whom those financial statements are directed by defining them as 'existing and potential investors, lenders and other creditors' that must rely on general purpose financial statements for much of the financial information they need.

These amendments should be applied for annual periods beginning on or after 1 January 2020. Earlier application is permitted.

Financial Accounting Standards Board (FASB): US GAAP

Accounting Standards Update (ASU) 2018-20, (Topic 842, Leases): Narrow-Scope Improvements for Lessors

On 31 October 2018, the FASB tentatively approved the following amendments designed to make lessor adoption of the new leases standard easier:

- As an accounting policy election, a lessor may account for sales tax and other similar taxes collected from a lessee as lessee costs. If this policy is elected, a lessor would exclude these costs from contract consideration and variable consideration and present revenue net of these costs. Certain disclosures will be required. A lessor's gross receipts taxes are excluded from this policy election.

- A lessor should exclude from variable payments all lessor costs that are explicitly required to be paid directly by a lessee on behalf of the lessor to a third party. Examples include property taxes and insurance. This means that the lessor would report revenue net of these amounts.

- ●Costs that are not part of contract consideration that are paid by a lessor to a third party and reimbursed by the lessee are considered lessor costs and would be accounted for as variable payments by the lessor. The lessor would therefore report these amounts gross on the income statement.

- These amendments will be applicable to all leases that exist as of the effective date and all new leases entered into on or after the effective date of the new leases standard. The effective date for these amendments will be the same as the effective date for the new leases standard. Entities already applying the new standard may apply these amendments (1) as of the entity's original effective date of the new leases standard, (2) in the first reporting period ending after the issuance of the amendments, or (3) in the first reporting period following the issuance of the amendments. Either retrospective or prospective adoption is permitted for such entities.

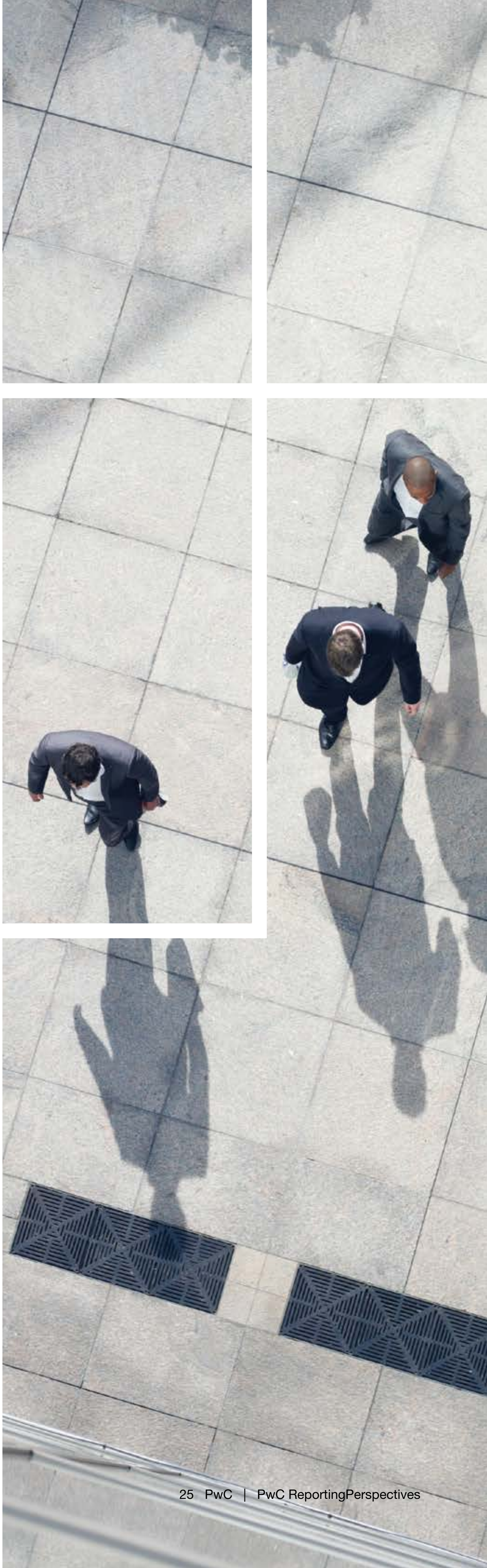
ASU 2018-17, Consolidation (Topic 810): Targeted Improvements to Related Party Guidance for Variable Interest Entities (VIE)

On 31 October 2018, the FASB issued new guidance ASU 2018-17, Consolidation (Topic 810): Targeted Improvements to Related Party Guidance for VIE that expands the application of a specific private company accounting alternative related to VIEs and changes the guidance for determining whether a decision-making fee is a variable interest.

Under the new ASU, a private company can make an accounting policy election to not apply VIE guidance to legal entities under common control if certain criteria are met. Previously, the election could only be made with respect to common control lease arrangements. If elected, the accounting policy election must be applied to all of the private company's current and future legal entities under common control that meet specified criteria. Additionally, a private company electing the alternative is required to provide detailed disclosures about its involvement with, and exposure to, the legal entity.

The amendments in the ASU also provide that indirect interests held through related parties under common control will be considered on a proportional basis when determining whether fees paid to decision makers and service providers are variable interests. Such indirect interests were previously treated the same as direct interests. The consideration of indirect interests on a proportional basis is consistent with how indirect interests held through related parties under common control are treated when determining if a reporting entity within a related party group is the primary beneficiary of a VIE.

For public companies, the new guidance is effective for fiscal years beginning after 15 December 2019 and interim periods within those fiscal years. For private companies, the new guidance is effective for fiscal years beginning after 15 December 2020 and interim periods within fiscal years beginning after 15 December 2021. Retrospective adoption is required. Early adoption is permitted, including adoption in an interim period.



Previous publications

Publications-1

Publications-2

Publications-3

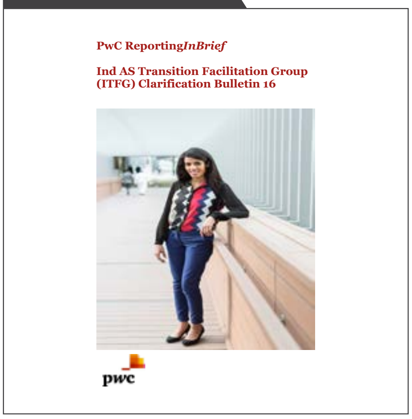
Publications-4

Publications-5

Publications-6

Publications-7

Publications-8



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