PwC ReportingPerspectives

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Contents

Editorial

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

The Companies (Indian Accounting Standards) Amendment Rules, 2019, notified the new lease standard Ind AS 116, which is effective for annual reporting periods beginning on or after 1 April 2019. This edition discusses the interaction of the new lease standard with other Ind ASs and the consequent impact which companies need to focus on while preparing their financial statements for the year ended 31 March 2020.

We also discuss the interaction between Ind AS 23 and Ind AS 115 in light of the IFRS Interpretation Committee's agenda decision on capitalisation of borrowing costs in relation to the construction of a residential multi-unit real estate development.

This edition also elaborates on the accounting for a software as a service (SaaS) cloud computing arrangement and the considerations issued by the European Securities and Markets Authority (ESMA) in its recent public statement on recognition of deferred tax assets arising from the carry forward of unused tax losses.

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

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

01 Ind AS 116, ‘Leases’ – interaction with other standards

At a glance

Under Ind AS 116, lessees will need to recognise virtually all of their leases on the balance sheet by recording a right-of-use asset and a lease liability. While this ‘gross up’ in total assets and total liabilities is the most obvious impact of adopting Ind AS 116, there are a number of less obvious impacts of the adoption of Ind AS 116, since it intersects with other Ind ASs. This article considers several consequences arising from Ind AS 116, including some of the impacts that Ind AS 116 will have for entities in applying:

- Ind AS 16, ‘Property, Plant and Equipment’;
- Ind AS 103, ‘Business Combinations’;
- Ind AS 109, ‘Financial Instruments’;
- Ind AS 12, ‘Income Taxes’;
- Ind AS 37, ‘Provisions, Contingent Liabilities and Contingent Assets’;
- Ind AS 108, ‘Operating Segments’;
- Ind AS 21, ‘The Effects of Changes in Foreign Exchange Rates’ and
- Ind AS 36, ‘Impairment of Assets’.

Interaction between Ind AS 116 and Ind AS 16

The determination of the lease term is a significant judgement in applying Ind AS 116. In determining the lease term, an entity must assess whether it is reasonably certain to exercise extension or early termination options. This judgement is important, because it affects the amount recorded for the entity’s lease obligation and related right-of-use (RoU) asset. The consideration of economic penalties beyond contractual termination payments, in determining the lease term of a cancellable or renewable lease, was concluded by the IFRS Interpretations Committee (IFRIC) in the context of IFRS 16, ‘Leases’. The committee’s agenda decision stated that an entity should consider the broader economics of the contract and not only contractual termination payments in assessing the lease term as per IFRS 16. Since Ind AS 116 is substantially converged with IFRS 16, the decisions of the IFRIC would be equally relevant for Ind AS reporters.

PwC’s observation:

Significant leasehold improvements undertaken (or expected to be undertaken) are considered when determining the lease term, because these leasehold improvements could provide economic benefit for the lessee when the option to extend or terminate the lease becomes exercisable. If significant leasehold improvements cannot be used beyond the date on which the lease contract could be terminated, this could indicate that the entity might incur more than an insignificant penalty if it terminates the lease before the end of the useful life of the improvements. The costs of abandoning or dismantling leasehold improvements might also need to be considered when determining the lease term.

While significant leasehold improvements can influence the lease term assessment under Ind AS 116, expectations about lease term also have an impact on accounting for leasehold improvements in accordance with Ind AS 16. Paragraph 56(d) of Ind AS 16 states that the legal or similar limits on the use of the asset, such as the expiry dates of related leases, should be considered in determining the useful life of an asset.

Paragraph 57 of Ind AS 16 refers to the period in which an asset is expected to provide utility to the entity, whereas Ind AS 116 requires optional periods to be included in the lease term where it is ‘reasonably certain’ that these options will be exercised. While it is possible that an entity could conclude that it expects to exercise an extension option even if not reasonably certain, in most cases, it would be expected that the useful life (that is, the depreciation period) of the leasehold improvements is no longer than the lease term under Ind AS 116.

The IFRIC recently discussed a submission asking whether the useful life of non-removable leasehold improvements is limited to the lease term. The IFRIC concluded that an entity applies paragraphs 56–57 of IAS 16, 'Property, Plant and Equipment', in determining the useful life of non-removable leasehold improvements. If the lease term of the related lease is shorter than the economic life of those leasehold improvements, the entity considers whether it expects to use the leasehold improvements beyond that lease term. If the entity does not expect to use the leasehold improvements beyond the lease term of the related lease, then applying paragraph 57 of IAS 16, it concludes that the useful life of the non-removable leasehold improvements is the same as the lease term.

PwC's observation:

In cases where the entity is able to practically and economically dismantle and redeploy the leasehold improvements at the end of the lease term, it might be reasonable for the useful life of the leasehold improvements to exceed the term of the related lease.

Interaction between Ind AS 116 and Ind AS 103

Impact in a business combination

The Ind AS 103 measurement principle is that identifiable assets acquired and liabilities assumed are measured at their acquisition date fair values. However, an exception exists in Ind AS 103 as it relates to leases in which the acquiree is the lessee. If an entity acquires an entity that is a lessee, it recognises the lease liability based on the present value of the remaining lease payments as if the acquired lease were a new lease at acquisition date. The lease term and discount rate will potentially be different from that used by the acquiree based on its Ind AS 116 assessment done at lease inception. Therefore, this will likely result in a difference between an acquirer's accounting for a lease and the accounting for the same lease in the separate financial statements of the acquired entity.

Even though RoU assets are generally recorded similarly to owned property, plant and equipment under Ind AS 16, and Ind AS 16 assets are recorded at fair value in a business combination, RoU assets are an exception to the general principle of measurement in Ind AS 103. In a business combination, the acquirer measures the RoU asset at an amount equal to the recognised lease liability, adjusted to reflect favourable or unfavourable lease terms compared with market terms.

Ind AS 103 also provides an exception for recognition of assets and liabilities related to short-term or low-value leases in a business combination, consistent with the exceptions provided in Ind AS 116.

Interaction between Ind AS 116 and Ind AS 36

At what level do you test?

Impairment should be identified at the individual asset level if the individual asset generates cash inflows that are largely independent from other assets. Where the recoverable amount of the RoU asset cannot be determined individually, the impairment test moves to the level of the cash-generating unit (CGU) to which the RoU asset belongs. Typically, an RoU asset does not generate cash inflows that are largely independent from other assets, and it should be grouped within a CGU for an impairment test in these circumstances. One exception may be an asset that is subleased and therefore may generate cash inflows that are largely independent from other assets. Another common exception relates to leased investment properties, accounted for under Ind AS 40, 'Investment Property'. In such a case, the leased investment property is an RoU asset that might have cash inflows (from tenants under a sublease) which are largely independent from other assets, and therefore this property could be considered for impairment at the individual asset level.

When do you test?

The general requirement of Ind AS 36 is that assets are tested for impairment where there is an impairment indicator, and this includes RoU assets. Where the RoU asset is part of a CGU that contains goodwill, indefinite-life intangible assets, or intangible assets that are not yet ready for use, it will be included as part of the annual impairment requirement.

PwC's observation:

A decline in fair value of an RoU asset due to market factors might not be considered an impairment indicator for a CGU if the RoU asset is not a significant component of the CGU.

How do you test?

Recoverable amount

Ind AS 36 tests the carrying value of the asset/CGU against the higher of value in use (VIU) and fair value less costs of disposal (FVLCD).

The 'higher of' requirement means that, if there is no headroom on a VIU basis, FVLCD should also be considered before concluding that an impairment is required. Similarly, VIU must be considered if an entity first performs an FVLCD test which indicates that the asset/CGU is impaired.

Liabilities

While RoU assets are included in a CGU when testing VIU, the related lease liabilities should be excluded, because these are a form of financing, and all financing cash flows are explicitly excluded from VIU.

VIU – expected cash flow model

The expected cash flow model will:

- exclude the lease payments included in the lease liability;
- use a pre-tax discount rate (typically estimated with reference to a post-tax weighted average cost of capital [WACC] discount rate) that should reflect a market assessment of capital structure rather than the entity's own structure;
- include cash outflows to replace leased assets at the end of the lease term which are essential to the ongoing operation of the CGU (that is, the RoU asset being tested for impairment only reflects the existing lease, so the most practical way to incorporate replacement is via a future capital expenditure cash outflow); and
- include cash outflows for expected future variable rents and short-term and low value leases that are not included in the lease liability.

VIU – discount rate

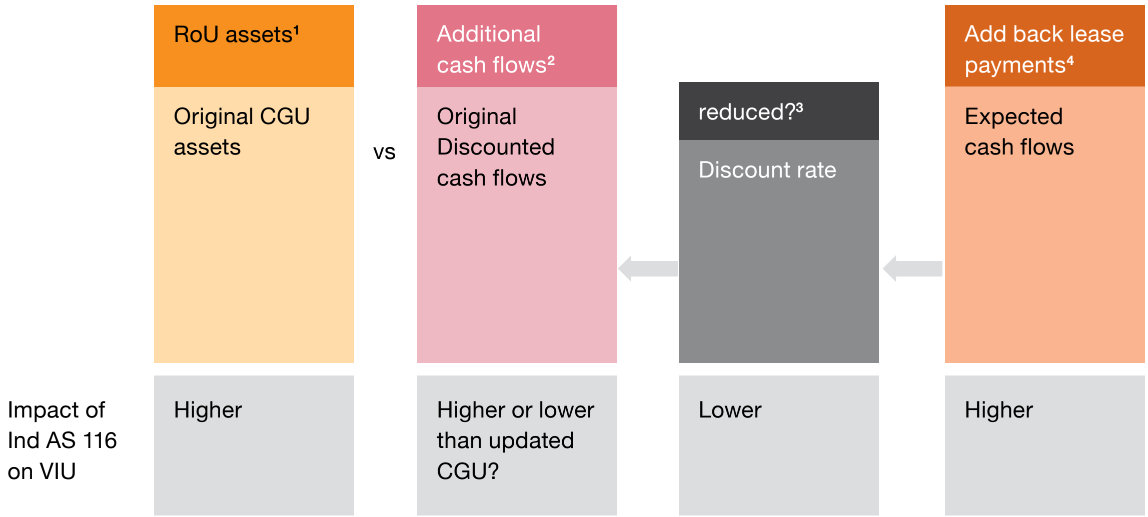
Projected future cash flows are discounted at a pre-tax rate that reflects both current market assessments of the time value of money and the risks specific to the asset/CGU for which the future cash flow estimates have not been adjusted. The rate is independent of the way in which the asset/CGU is financed. It is estimated from current market transactions for similar assets or from the WACC of a listed entity that has a single asset or portfolio of assets that are similar, in terms of service potential and risks, to the asset/CGU under review. As a result, entities should be using a WACC that reflects market expectations of the market-based capital structure where both the cost of debt and cost of equity reflect the effects of new lease accounting.

Areas to consider include:

- Lease liabilities would be expected to be considered as part of the capital structure. The peer group based WACC needs to reflect the impact of Ind AS 116. However, since historical lease liabilities under Ind AS 116 are not available, it might be necessary to derive an estimate of the historical capital structure (for example, based on Ind AS 17 note disclosures) which can then be refined going forward, as capital structure data becomes available after adoption of Ind AS 116.
- WACC depends on the market assessment of an adequate capital structure, represented by the respective peer group companies and not the entity's own capital structure. The impact of the application of Ind AS 116 on the peer group's WACC and the entity's WACC might be different if the entity has relatively more or fewer lease liabilities in comparison to the peer group.

VIU – impact of the above items

Ind AS 116 might cause a reduction in headroom if the change in VIU-discounted cash flows is lower than the increase in CGU assets being tested. This depends on the interaction of increased expected cash flows and lower discount rates, as illustrated below:



[1] There will be more assets in the CGU, because it now includes RoU assets.

[2] There could be a change in gross cash flows, because the lease payments that are part of the lease liability are excluded, although these could be somewhat offset by an increase in cash outflows to replace leased assets where the lease term is shorter than the model life.

[3] The discount rate could be lower due to the inclusion of debt-like leases which will increase the debt to equity ratio.

[4] If the increase in present value cash flows is lower than the increase in CGU assets being tested, headroom will reduce, possibly leading to an impairment of the CGU. However, this is not expected to be common.

If there is an impairment

Any impairment arising on a separately tested RoU asset is allocated to that asset. Where the RoU asset is part of a CGU, the impairment of the CGU as a whole should be allocated to write down the CGU assets in the following order:

- recorded goodwill; and
- the other assets in the CGU on a pro rata basis, based on the carrying amount of each asset in the CGU.

However, within this allocation framework, each asset should be reduced only to the highest of:

- its FVLCD if measurable;
- its VIU, if this can be determined; and
- zero.

The amount of impairment loss that would otherwise have been allocated to the asset should be allocated pro rata to the CGU's other assets.

Interaction between Ind AS 116 and Ind AS 109

Lease liabilities are a financial instrument, although they are outside the scope of certain parts of Ind AS 107/Ind AS 109. Lease liabilities are within the scope for Ind AS 107 disclosure (except for disclosure of fair value), within the scope of Ind AS 109 for derecognition, and can be part of a designated hedging relationship. Derivatives embedded in leases are also subject to the Ind AS 109 embedded derivative requirements.

Lease liabilities denominated in currencies other than an entity's functional currency will give rise to foreign exchange risk and (without hedge accounting) will be retranslated through profit or loss, causing volatility.

Interaction between Ind AS 116 and Ind AS 12

A lessee normally recognises an asset and a lease liability when it enters into most leases under Ind AS 116. Recognition of the asset and liability has no immediate tax impact, and tax deductions are often received when the lease payments are made. Ind AS 12 does not specifically address the tax effects of leases. There are two principal approaches to the deferred tax accounting for lessees. One approach considers the lease as a single transaction in which the asset and liability are integrally linked, so there is no net temporary difference at inception. The other approach considers the asset and the liability separately, in which case there might be a temporary difference on initial recognition, which would be subject to the initial recognition exemption described in paragraphs 15 and 24 of Ind AS 12. The choice of approach is a matter of accounting policy, to be applied on a consistent basis.

PwC's observation:

The IFRIC considered the deferred tax implications of finance leases in 2005 and noted that there was diversity in practice in applying the requirements of IAS 12 to assets and liabilities arising from finance leases. The committee agreed not to develop any guidance, because the issue fell directly within the scope of the IASB's short-term convergence project on income taxes. Subsequently, this project was suspended. However, in October 2018, the International Accounting Standards Board (IASB) decided to propose a narrow scope amendment that would narrow the initial recognition exemption in paragraphs 15 and 24 of IAS 12 so that it would not apply to transactions that give rise to both taxable and deductible temporary differences to the extent that the amounts recognised for the temporary differences are the same.

Interaction between Ind AS 116 and other Ind AS

Ind AS 37 – asset retirement obligations

When recognising an asset, an entity is required to record in its cost an initial estimate of any costs of dismantling and removing the item and restoring the site on which it is located. An offsetting provision, commonly known as an 'asset retirement obligation', is recorded in accordance with Ind AS 37. In some industries (such as the extractive industries), these provisions can be substantial. In performing remediation activities to settle these obligations, entities might utilise leased assets.

Under Ind AS 116, a lease usually gives rise to an RoU asset and a lease liability on the entity's balance sheet. It is only appropriate to reduce the Ind AS 37 asset retirement obligation as remediation work is complete. While some might view this as 'double counting' of the entity's liabilities, the leasing of equipment does not reduce the provision for remediation to be completed, and so it would not be appropriate to reduce the Ind AS 37 provision when the Ind AS 116 lease liability is recognised.

PwC's observation:

This treatment is consistent with the accounting when equipment is purchased for the purpose of performing remediation activities. When equipment is purchased, an entity records an asset for the equipment and a liability for any obligation to pay for it, but it does not derecognise the Ind AS 37 obligation until remediation activity is undertaken.

Ind AS 108 – segment reporting

In many circumstances, when disclosing entity-wide information about geographical areas in accordance with Ind AS 108, an RoU asset would be included within the non-current asset disclosure required by paragraph 33 of Ind AS 108. For most types of non-current assets (including RoU assets), an entity must disclose the amount of non-current assets located in the entity's country of domicile and all foreign countries in total in which the entity holds assets. If assets in an individual foreign country are material, those assets should be disclosed separately.

If a measure of segment assets and liabilities is provided to the chief operating decision maker (CODM), this amount should be disclosed for each segment, as required by paragraph 23 of Ind AS 108. Disclosure of additions to non-current assets might also be required as per paragraph 24 of Ind AS 108. If RoU assets and lease liabilities are included in the information provided to the CODM, these should be included in these disclosures. If they are not included, the RoU assets and lease liabilities should be considered in reconciling to the entity's assets and liabilities in accordance with paragraph 28 of Ind AS 108.

Ind AS 21 – the effects of changes in foreign exchange rates

When a reporting entity enters into a lease in a currency other than its functional currency, the resulting RoU asset is a non-monetary asset and it is not revalued, similar to owned property, plant and equipment. Lease liabilities related to the foreign currency lease are monetary and will be translated each reporting period, using the closing exchange rate. Changes in the exchange rate will give rise to a foreign exchange gain or loss recorded in profit and loss. RoU assets and lease liabilities of foreign operations must be translated into the reporting entity's presentation currency, which could give rise to a cumulative translation adjustment (recorded in other comprehensive income [OCI]).

PwC's observation:

Where RoU assets and lease liabilities are attributable to a foreign entity but recorded in a group's consolidated financial statements as a consolidation adjustment (that is, where the foreign entity does not apply Ind AS 116), these assets and liabilities should be considered in the currency translation process as if recorded within the foreign entity.

Key takeaway

The impact of the interaction of Ind AS 116 with other Ind AS is significant. Apart from Ind AS 116, Ind AS reporters need to also consider the above consequential impact in other Ind ASs while preparing their financial statements for the year ending 31 March 2020.

(Source: PwC In depth INT 2019-12, IFRS 16, 'Leases' – interaction with other standards)

02 Interaction between Ind AS 23, 'Borrowings Costs', and Ind AS 115, 'Revenue from Contracts with Customers'

At a glance

The core principle of Ind AS 23 is simple: borrowing costs that are directly attributable to the acquisition or construction of a qualifying asset must be capitalised. All other borrowing costs should be expensed.

There are only two defined terms in Ind AS 23: 'borrowing costs' and 'qualifying asset'.

Borrowing costs are 'interest and other costs that an entity incurs in connection with the borrowing of funds'. A qualifying asset is defined as 'an asset that necessarily takes a substantial period of time to get ready for its intended use or sale'.

In March 2019, the IFRIC published an agenda decision on 'over time transfer of a constructed good'. The agenda decision responds to a question received about the application of IAS 23 Borrowing Costs to the construction of a multi-unit housing development. In the said submission to IFRIC, the real estate developer recognises revenue as per IFRS 15, Revenue from Contracts with Customers.

Ind AS 23, 'Borrowing Costs', and Ind AS 115 are substantially converged with IAS 23 and IFRS 15, respectively. Accordingly, the conclusions of the IFRIC are equally relevant for Ind AS reporters.

This article provides an overview of the conclusion reached by the IFRIC and discusses the interaction between Ind AS 23 and Ind AS 115.

Overview of the agenda decision

The IFRIC received a query about the capitalisation of borrowing costs in relation to the construction of a residential multi-unit real estate development (building).

In the fact pattern described in the query:

a. A real estate developer (entity) constructs the building and sells the individual units in the building to customers.
b. The entity borrows funds specifically for the purpose of constructing the building and incurs borrowing costs in connection with that borrowing.
c. Before construction begins, the entity signs contracts with customers for the sale of some of the units in the building (sold units).
d. The entity intends to enter into contracts with customers for the remaining part-constructed units (unsold units) as soon as it finds suitable customers.
e. The terms of, and relevant facts and circumstances relating to, the entity's contracts with customers (for both the sold and unsold units) are such that, applying paragraph 35(c) of IFRS 15 Revenue from Contracts with Customers, the entity transfers control of each unit over time and, therefore, recognises revenue over time. The consideration promised by the customer in the contract is in the form of cash or another financial asset.

The requester asked whether the entity has a qualifying asset as defined in IAS 23 and, therefore, capitalises any directly attributable borrowing costs.

IFRIC response:

Applying paragraph 8 of IAS 23, an entity capitalises borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. Paragraph 5 of IAS 23 defines a qualifying asset as 'an asset that necessarily takes a substantial period of time to get ready for its intended use or sale'.

Accordingly, the entity needs to assess whether, in the fact pattern above, it recognises an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Depending on the particular facts and circumstances, the entity might recognise a receivable, a contract asset and/or inventory.

The IFRIC concluded that in the fact pattern described in the request:

a. A receivable that the entity recognises is not a qualifying asset. Paragraph 7 of IAS 23 specifies that financial assets are not qualifying assets.

b. A contract asset that the entity recognises is not a qualifying asset. The contract asset (as defined in Appendix A to IFRS 15) would represent the entity's right to consideration that is conditioned on something other than the passage of time in exchange for transferring control of a unit. The intended use of the contract asset—to collect cash or another financial asset—is not a use for which it necessarily takes a substantial period of time to get ready.

c. Inventory (work-in-progress) for unsold units under construction that the entity recognises is not a qualifying asset. In the fact pattern described in the request, this asset is ready for its intended sale in its current condition—i.e. the entity intends to sell the part-constructed units as soon as it finds suitable customers and, on signing a contract with a customer, will transfer control of any work in progress relating to that unit to the customer.

FAQs

1. In the above fact pattern, why cannot the entity capitalise borrowing costs even though the physical construction of the building takes a substantial period of time?

Response: An entity considers whether the underlying asset in respect of the building—i.e. receivable, contract asset or inventory (work-in-progress) relating to unsold units—meets the definition of a qualifying asset for capitalisation of borrowing costs. The entity does not consider the underlying building itself.

2. Why does unsold inventory not qualify as qualifying assets in the above fact pattern?

Response: Paragraph 7 of IAS 23/Ind AS 23 states that inventories may be qualifying assets depending on the circumstances. Accordingly, an entity assesses whether inventory meets the definition of a qualifying asset (defined in IAS 23/Ind AS 23 as 'an asset that necessarily takes a substantial period of time to get ready for its intended use or sale'). In the fact pattern discussed above, the entity intends to enter into contracts with customers for the unsold units as soon as it finds suitable customers, and when it signs a contract with a customer, it (a) would derecognise any inventory asset for the part-constructed unit sold (because it no longer controls the unit), and (b) may recognise a contract asset and/or receivable for consideration receivable from the customer. Hence, on signing a contract with a customer, the entity would no longer have inventory relating to the unit. In other words, any inventory asset relating to unsold units is ready for its intended sale in its current condition and would not necessarily take a substantial period of time to get ready for such sale.

3. Does pattern of recognition of revenue (at a point in time vs over time) impact capitalisation of borrowing costs?

Response: Yes. Where revenue is recognised at a point in time, the nature of the entity's promise to the customer is to transfer a fully constructed property. The entity would recognise revenue when it satisfies its performance obligation at the point in time at which the customer obtains control of the fully constructed property. Before this date, applying IAS 2/Ind AS 2, 'Inventories', the entity recognises inventory (work-in-progress) for the property under construction.

When revenue is recognised over time, the nature of the entity's promise to the customer is to transfer the property as it is being constructed—in other words, to provide construction services (together with embedded materials). Because the customer obtains control of the property as the property is being constructed, the entity satisfies its performance obligation and recognises revenue over time as it constructs the property. The customer, and not the entity, controls the property as it is being constructed and, thus, the entity would not recognise inventory (work in progress) for that part-constructed property. Instead, applying IFRS 15/Ind AS 115, it would recognise a receivable or a contract asset representing its right to consideration in exchange for transferring the part-constructed property to the customer.

Accordingly, in a different situation, where an entity enters into a contract with a customer to transfer control of real estate on completion of construction, it is likely that the real estate units would meet the definition of a qualifying asset, and so interest would be capitalised. Judgement is required as to whether interest could be capitalised on the cost of the land on which the building is being constructed, based on specific facts and circumstances. Entities should consider when control of the land transfers in determining whether it meets the definition of a qualifying asset.

Key takeaway

Ind AS reporters, particularly those in the real estate sector, recognising revenue over time as per Ind AS 115, need to carefully assess the implication of the IFRIC decision on capitalisation of their borrowing costs.

(Source: IFRS IC Agenda discussion)

03 Cloud computing : Accounting considerations for software as a service

What is cloud computing?

Cloud computing is essentially a model for delivering information technology services in which resources are retrieved from the internet through web-based tools and applications, rather than a direct connection to a server. Data and software packages are stored in servers. Cloud computing structures allow access to information as long as an electronic device has access to the internet. This type of system allows employees to work remotely. Cloud computing is so named because the information being accessed is found in the 'cloud', and does not require a user to be in a specific place to gain access to it. Companies may find that cloud computing allows them to reduce the cost of information management, since they are not required to own their own servers and can use capacity leased from third parties. Additionally, the cloud-like structure allows companies to upgrade software more quickly.

There are various types of cloud computing arrangements. Cloud services usually fall into one of three service models: infrastructure, platform and software. In this article, we focus on software as a service (SaaS).

What is SaaS?

SaaS is a software distribution model in which the customer does not take possession of the supplier's hardware and application software. Instead, customers access the supplier's hardware and application software from devices over the internet or via a dedicated line. In these types of arrangements, the customer does not manage or control the underlying cloud infrastructure, including the network, servers, operating systems, storage, and even individual application software capabilities, with the possible exception of limited user-specific application software configuration settings, nor is the customer responsible for upgrades to the underlying systems and software.

What are the key issues to consider?

In practice, various application issues can arise relating to the customer's accounting in SaaS arrangements. These arrangements may often be bundled with other products and services, such as implementation, data migration, business process mapping, training, and project management.

For simplicity, this article only focuses on accounting for arrangements for the customer's access to hardware and application software and, more specifically, on fees paid to the supplier for the customer's access to the supplier's application software.

The key accounting issues identified with these arrangements arise as a result of a change in the business model. The original business model, before the implementation of SaaS, involved an entity using its own servers and applications, resulting in the recognition of property, plant and equipment as well as intangible assets on the entity's balance sheet. Under the new business model, SaaS, there is the possibility of recognising these cash flows as operating expenses. This is illustrated by the example below:

The IFRIC received a request about how a customer should account for a SaaS cloud computing arrangement in which the customer contracts to pay a fee in exchange for a right to receive access to the supplier's application software for a specified term. The supplier's software runs on cloud infrastructure managed and controlled by the supplier. The customer accesses the software on an as needed basis over the internet or via a dedicated line. The contract does not convey to the customer any rights over tangible assets.

Does the customer receive a software asset at the contract commencement date or a service over the contract term?

The IFRIC noted that a customer receives a software asset at the contract commencement date if either (a) the contract contains a software lease, or (b) the customer otherwise obtains control of the software at the contract commencement date.

A software lease

IFRS 16 Leases defines a lease as 'a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration'. Paragraphs 9 and B9 of IFRS 16 explain that a contract conveys the right to use an asset if, throughout the period of use, the customer has both:

a. the right to obtain substantially all the economic benefits from use of the asset (an identified asset); and
b. the right to direct the use of that asset.

Paragraphs B9–B31 of IFRS 16 provide application guidance on the definition of a lease. Among other requirements, that application guidance specifies that a customer generally has the right to direct the use of an asset by having decision-making rights to change how and for what purpose the asset is used throughout the period of use. Accordingly, in a contract that contains a lease, the supplier has given up those decision-making rights and transferred them to the customer at the lease commencement date.

The IFRIC observed that a right to receive future access to the supplier's software running on the supplier's cloud infrastructure does not in itself give the customer any decision-making rights about how and for what purpose the software is used—the supplier would have those rights by, for example, deciding how and when to update or reconfigure the software, or deciding on which hardware (or infrastructure) the software will run. Accordingly, if a contract conveys to the customer only the right to receive access to the supplier's application software over the contract term, the contract does not contain a software lease.

A software intangible asset

IAS 38 defines an intangible asset as 'an identifiable non-monetary asset without physical substance'. It notes that an asset is a resource controlled by the entity and paragraph 13 specifies that an entity controls an intangible asset if it has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits.

The committee observed that, if a contract conveys to the customer only the right to receive access to the supplier's application software over the contract term, the customer does not receive a software intangible asset at the contract commencement date. A right to receive future access to the supplier's software does not, at the contract commencement date, give the customer the power to obtain the future economic benefits flowing from the software itself and to restrict others' access to those benefits.

Consequently, the committee concluded that a contract that conveys to the customer only the right to receive access to the supplier's application software in the future is a service contract. The customer receives the service—the access to the software—over the contract term. If the customer pays the supplier before it receives the service, that prepayment gives the customer a right to future service and is an asset for the customer.

Key takeaway

SaaS and cloud computing arrangements are topics that are currently evolving in practice and views on the accounting treatment of such arrangements may continue to develop in the future. Under US GAAP, Accounting Standards Update (ASU) 2015-05, Customer's Accounting for Fees Paid in a Cloud Computing Arrangement, helps entities evaluate the accounting for fees paid by a customer in a cloud computing arrangement by providing guidance for determining when an arrangement includes a software licence and when an arrangement is solely a hosted cloud computing arrangement service. A customer recognises an intangible asset, assuming the criteria for capitalisation of internal-use software are met, if

- the customer has the contractual right to take possession of the software at any time during the hosting period without significant penalty; and
- it is feasible for the customer to either run the software on its own hardware or contract with another party unrelated to the vendor to host the software.

If either criterion is not met, the arrangement is accounted for as a service contract.

(Source: PwC report on 'Cloud Computing: Accounting considerations for software as a service')

04 European Securities and Markets Authority (ESMA) public statement on IAS 12

On 15 July 2019, ESMA issued a public statement setting out its expectations regarding the application of the requirements in IAS 12, 'Income Taxes', by issuers relating to the recognition, measurement and disclosure of deferred tax assets (DTAs) arising from unused tax losses in IFRS financial statements. Since Ind AS 12 is substantially converged with IAS 12, considerations highlighted by ESMA are useful for Ind AS reporters.

The public statement specifically addresses two aspects which European enforcers often challenge regarding the application of IAS 12 by issuers, namely:

- the probability that future taxable profits will be available against which unused tax losses and unused tax credits can be utilised (paragraph 34 of IAS 12), assessed through the criteria provided by paragraph 36 of IAS 12
- the 'convincing other evidence' that sufficient taxable profit will be available against which the unused tax losses or unused tax credits can be utilised by the issuer (paragraph 35 of IAS 12), in cases where the issuer has a history of recent losses.

1. **Assessing the probability that future taxable profits will be available**

   IAS 12 does not define how probability is assessed when determining if DTAs arising from unused tax losses should be recognised. Therefore, ESMA is of the view that the concept of probability should be understood in the same way as in other IFRS standards and be based on a 'more likely than not' threshold (i.e. >50%). Consequently, when assessing if it is probable that future taxable profits will be available, issuers should consider all available evidence, both negative and positive. Issuers should determine whether sufficient positive evidence outweighs existing negative evidence, and thus the 50% threshold is passed. In this respect, ESMA highlights the following:

   - Generally, the longer the estimates/forecasts extend into the future, the less reliable they are; their weight should be assessed accordingly.
   - The existence of unused tax losses is strong evidence that future taxable profit may not be available (paragraph 35 of IAS 12).
   - Forecasts/planning should be reasonable, realistic and achievable in all cases.
   - When issuers have a history of recent losses and do not have sufficient taxable temporary differences, forecast/planning should provide convincing (other) evidence in order to recognise DTAs.

When weighing the negative and positive evidence related to the recognition of DTAs, losses arising from operations (i.e. low product demand or sales margins) require stronger offsetting positive evidence to conclude that sufficient future profits will be available than profit or losses arising from a one-time event or from non-recurring events, such as a move to a new factory or a fire. Restructuring may provide positive convincing evidence if the business line which was the sole source of the past losses is closed.

Although tax losses with no expiry date may be more likely to be offset by future profits, they alone do not provide evidence that 'sufficient taxable profits are probable' to enable DTAs to be recognised. The tax losses carried forward may only be recognised if it is probable that sufficient future taxable profit will be generated against which the tax losses can be used. It is not sufficient to simply discontinue making losses, but rather issuers need to provide evidence that sufficient future taxable profits will be generated. Similarly, when tax losses have short expiration periods, the DTAs should be subject to a more critical review since there will be less time to generate sufficient profits in order to use the available tax losses.

Likewise, management's assessment of the entity's ability to continue as a going concern does not, in itself, justify recognising a DTA. On the contrary, if material uncertainties exist which may cast significant doubts on the entity's ability to continue as a going concern (e.g. due to liquidity problems), then the recognition of DTAs should be analysed with heightened scepticism.

When evaluating whether it is probable that sufficient future taxable profits will be available, the nature, origin and timing of such profit should be considered. The following examples of positive and negative evidence, for instance, may support an assertion that it is probable/not probable that taxable profits will be available (this list is non-exhaustive and only indicative):

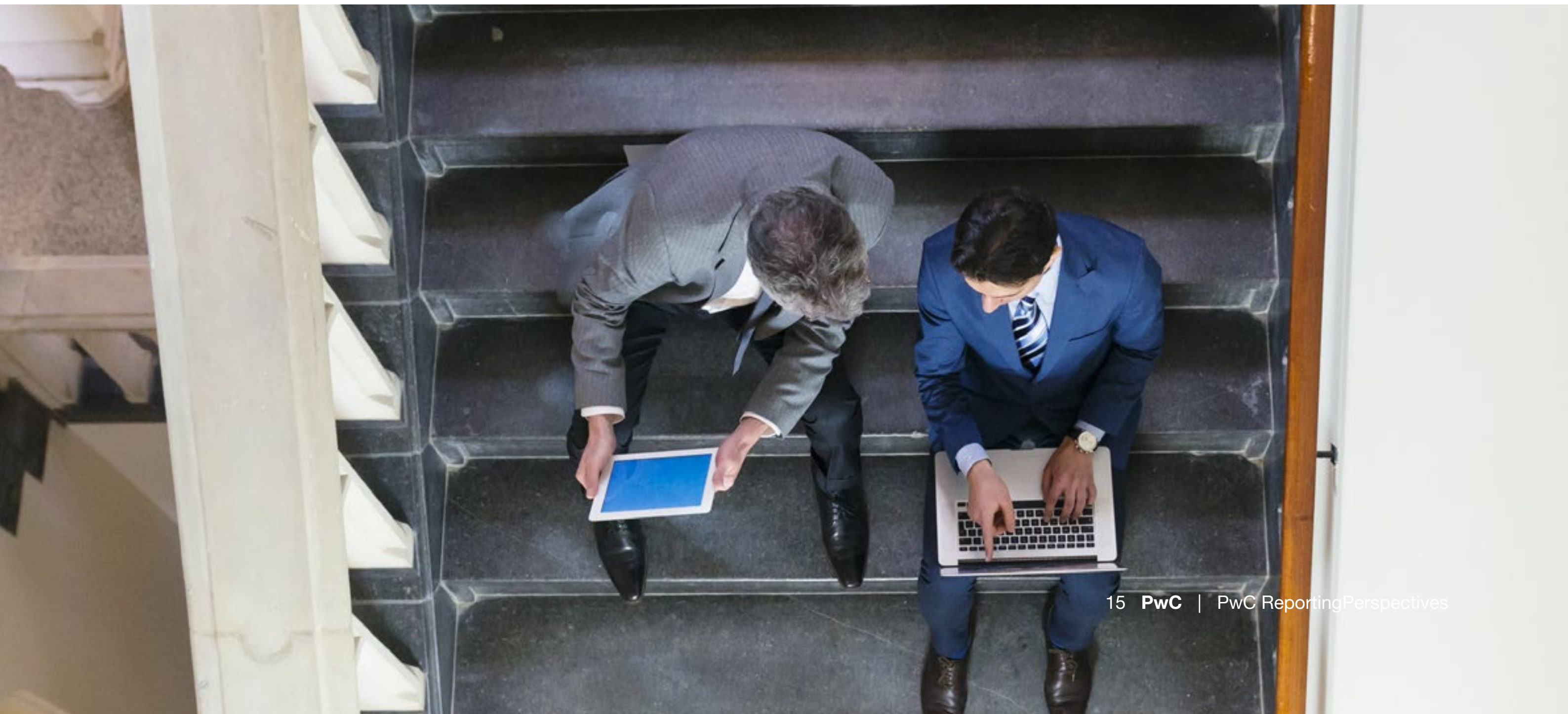
Positive evidence	Negative evidence
• Losses occurred due to identifiable one-time/non-recurring events • A strong earnings history exclusive of the loss that created the unused tax loss carried forward (provided that the loss is not expected to recur) • New business opportunities, e.g. new patents • Restructuring or disposal which clearly eliminates the loss sources • Convincing tax planning strategies • Firm sales backlog or new contracts (considering also past realisation of sales backlog) • Business acquisitions generating sustainable profit margins which are sufficient to enable the issuer to utilise existing tax losses carried forward and which can be utilised for that purpose (e.g. in the same tax jurisdiction)	• A recent history of operating losses for tax purposes • The taxable entity is a start-up business • History of significant variances of actual outcomes against business plans • Losses of major customers and/or of significant contracts • Uncertainty regarding the issuer's going concern • History of restructuring without returning to profitability or emerging from bankruptcy • The taxable entity expects losses in early future years • The taxable entity has a history of unused tax losses and/or credits expiring • The losses relate to the core activity of the issuer and thus may reoccur in the future

2. Assessing whether convincing evidence supports the expectation of future taxable profits

ESMA expects that convincing other evidence should be objectively verifiable to support the recognition of DTAs. For instance, a history of recent losses is verifiable objective negative evidence against the availability of sufficient future taxable profit. In this respect, it is also ESMA's view that, because estimates of future taxable profits require significant judgement, the more negative evidence that exists, the less reliance should be placed on the projections of future taxable income.

ESMA notes that reliability of profit forecasts also depends on the facts and circumstances of each case, such as the industry/sector of activity and/or the experience of issuers. For example, issuers with long-term contracts (e.g. in the real estate industry, or in concession agreements) may be more easily able to convincingly support the recognition of DTAs even if their budgets are only short term. On the other hand, start-ups with no extended history of financial results or issuers operating in sectors with a history of volatility in earnings may need to provide more extensive other convincing evidence of the reliability of their profit forecasts.

When estimating future taxable profit, it is ESMA's expectation that issuers should not anticipate or consider future events which cannot be controlled by them and are still highly uncertain. These include future changes in enacted tax laws or rates (other than changes that are already substantively enacted), possible business combinations, events that depend on future market conditions or events that are inconsistent with financial reporting assertions or with previously communicated strategies.



In addition, when assessing the probable future taxable profits, issuers should also ensure the reasonableness of their business plan and its impact on future taxable profits (including their history/capacity of accomplishing their stated plans and the consistency with relevant industry data and trends), and the consistency of assumptions compared to prior periods and projections used in other financial statement estimates for elements that should be comparable (e.g. goodwill impairment).

In this regard, ESMA notes that while the underlying assumptions between impairment testing and budget planning need to be consistent, the objective of each analysis is different and therefore some key differences can be expected. For example, the risk/uncertainty inherent to the future should be reflected in the expected future taxable profits when applying the recognition criteria for DTAs under IAS 12.

ESMA acknowledges that when currently profitable issuers without a recent history of loss recognise DTAs, they often use their current plan to support the recognition. IAS 12 does not define a time period over which an assessment of expected taxable profits is made. ESMA notes while there is no specific time limit in the standard concerning the period of the profit forecast, reliability decreases the further out into the future the forecast extends. The longer the forecast extends, the more unforeseen events and circumstances outside an issuers' control may arise that impact the reliability of taxable profit forecasts. Therefore, issuers should exercise caution when their planning period for purposes of DTA recognition exceeds their normal planning cycle.

Tax planning opportunities can also be used to support the recognition of DTAs (paragraph 29 (b) of IAS 12). ESMA considers that the actions foreseen must be realistic, tax profitable and consistent with the issuer business strategy. Furthermore, it is ESMA's expectation that the amount of the future taxable profits expected to be generated by such proposed strategies takes into account the expected incremental deductible costs of implementing them.

Key takeaway

Since Ind AS 12 is substantially converged with IAS 12, the considerations highlighted by ESMA are relevant for Ind AS reporters, in particular, when assessing whether DTAs fulfil the recognition criteria set out in Ind AS 12.

(Source: ESMA public statement on IAS 12)

05 Recent technical updates

Institute of Chartered Accountants of India (ICAI)

Accounting Standards Board (ASB)

Presentation of dividend distribution tax (DDT)

The ASB of ICAI has issued updated FAQs clarifying the presentation of DDT in light of the amendments to Ind AS 12 notified by the Ministry of Corporate Affairs effective from accounting periods beginning on or after 1 April 2019.

The amendments, amongst other matters, included the following new para 67A in Ind AS 12:

"An entity shall recognise the income tax consequences of dividends as defined in Ind AS 109 when it recognises a liability to pay a dividend. The income tax consequences of dividends are linked more directly to past transactions or events that generated distributable profits than to distributions to owners. Therefore, an entity shall recognise the income tax consequences of dividends in profit or loss, OCI or equity according to where the entity originally recognised those past transactions or events."

The ASB has clarified that Ind AS 12 para 65A states that "When an entity pays dividends to its shareholders, it may be required to pay a portion of the dividends to taxation authorities on behalf of shareholders. In many jurisdictions, this amount is referred to as a withholding tax. Such an amount paid or payable to taxation authorities is charged to equity as a part of the dividend."

In India, the dividend is received by the shareholders with an imputed tax credit in the sense that it will not be charged to further tax by the taxation authorities in the hands of shareholders, implying that DDT is covered by the situation of paragraph 65A.

The dividends are not taxable in the hands of shareholders considering that DDT is paid by the company that distributed the dividend. Had there been no DDT mechanism, dividends received would have been taxable in the hands of recipients, though recently they have been made taxable if the amount of dividend exceeds specified limits. In this situation also, the tax rate applicable is lower in view of the fact that tax on dividend has already been collected in the form of DDT. In India, the amount of dividend is grossed up by the company for computation of DDT and shareholders receive a net amount of the dividend after deducting tax. This implies that DDT is a tax paid by a company on behalf of its shareholders. It is pertinent to note that the DDT mechanism was introduced to replace the mechanism of tax deduction at source, commonly referred to as withholding tax primarily to reduce the operational difficulties involved in that tax collection structure.

Therefore, in view of the above, DDT, in substance, is payment by the company on behalf of shareholders and, therefore, covered by paragraph 65A of Ind AS 12. Presentation of DDT paid on the dividends should be consistent with the presentation of the transaction that creates those income tax consequences. Therefore, DDT should be recognised in profit or loss if the dividend/ interest itself is recognised in profit or loss. If the dividend is recognised in equity, the presentation of DDT should be consistent with the presentation of dividend, i.e. to be recognised in equity.

Expert Advisory Committee (EAC) opinions

Computation of effective interest rate on borrowings

Facts and query:

The company is a leading public sector undertaking in India operating in the power sector. To finance its capital expenditure, the company takes a term loan from multilateral/bilateral agencies such as World Bank, Asian Development Bank and KfW. The company enters into a loan for EUR 500 million with a foreign lender.

The loan agreement with the lenders sets out the rate of interest and fees payable by the company to the lenders. This loan is guaranteed by the Government of India (GOI) for due and punctual payment of the principal, interest and other charges through a separate guarantee agreement.

The company is required to pay an initial guarantee fee to GOI on the sanctioned amount and thereafter a guarantee fee is payable in April of every year on the amount outstanding at the beginning of the year as per the office memorandum of Ministry of Finance, GoI.

Should the subsequent guarantee fee paid to GoI, as stated above, be considered for computation of effective interest rate in compliance with the provisions of Ind AS 109?

View:

The EAC noted that the guarantee provided by GOI in the extant case is a precondition for obtaining and continuing with the loan facility as per the loan agreement. Hence, as long as the loan continues, the guarantee will also continue and therefore, during the term of the loan, the guarantee is not cancellable. The effective interest method is the rate that exactly discounts the estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset or to the amortised cost of a financial liability. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs, and all other premiums or discounts.

Fees paid or received between parties to the contract that are an integral part of the effective interest rate and transaction costs are to be considered while applying the effective interest method. Further, the fees that are an integral part of the effective interest rate of a financial liability include the origination fee paid on issuing such a liability. Accordingly, the committee is of the view that the origination fee referred to above is applicable in the extant case if the fees are paid/received between the parties to the contract (viz. the lender and the borrower in the case of a loan). Since the guarantee fee (initially as well as subsequently) in the extant case is not paid between the lenders and borrowers, the committee is of the view that the same cannot be considered as ‘fees paid or received between parties to the contract that are an integral part of the effective interest rate’. The committee further noted that transaction costs are incremental costs that are directly attributable to the acquisition or issue of a financial liability and an incremental cost is one that would not have been incurred if the entity had not acquired or issued the financial instrument. The committee was of the view that the guarantee fee paid (initially as well as subsequently) in the extant case is an incremental cost which is directly attributable to the acquisition of the loan facility as this cost would not have been incurred if the company had not incurred the loan liability. Accordingly, the committee is of the view that the financial guarantee fee paid (initially as well as subsequently) by the company should be considered in the extant case for computation of the effective interest rate while measuring the loan liability at amortised cost in compliance with the provisions of Ind AS 109.

Disclosure of government grants

Facts and query:

The company is engaged in the business of manufacturing high-end stainless steel castings and high-precision metal components for its customers across the globe. It was founded in 1963 as a private limited company and had received grants from GoI. With respect to a particular grant, the company had no repayment obligation to the government authority.

How should the company present the government grant for which no repayment obligation has been imposed by the concerned government body in its Ind AS financial statements?

View:

The EAC opined that the government grant in the given case should be classified and presented under the head 'Non-current liabilities' and 'Current liabilities' in the balance sheet considering the requirements of Schedule III to the Companies Act, 2013, and Ind AS 1, 'Presentation of Financial Statements', and not as a separate line item between 'Equity' and 'Other non-current liabilities' until the same is recognised in the statement of profit and loss on a systematic basis over the periods in which the company will recognise as expenses the related costs for which the grant is intended to compensate.

Classification of consumer deposits collected for liquid petroleum gas (LPG) connections

Facts and query:

The querist stated that oil companies operating in the public sector – collectively referred to as oil marketing companies (OMCs) – are primarily engaged in the business of refining and marketing of petroleum products. Among other products, OMCs sell LPG to domestic as well as non-domestic customers. OMCs supply LPG in cylinders which are fitted with specially designed valves and regulators. OMCs normally take deposits for cylinders and regulators from consumers. These deposits are taken based on the number of cylinders issued and the deposit amount is uniform across India. As per the agreement, a customer can surrender the connection anytime and OMCs are obliged to repay the full deposit amount.

Should the aforesaid deposit be classified as non-current in the Ind AS financial statements of the OMC?

View:

The EAC opined that the classification by the OMCs of deposits received by them from their LPG consumers towards supply of cylinders and regulators as non-current financial liability is not appropriate and the same should be classified as current financial liability, primarily since the OMCs do not have the unconditional right to defer settlement of the liability for at least twelve months after the reporting period.

Company's policy on transfer price for segment revenue and segment results under segment reporting

Facts and query:

A public sector entity is engaged in the mining of bauxite, manufacture of alumina and aluminium, and generation of power at a captive power plant. In the production process, alumina is transferred from the refinery (chemical segment) to the aluminium smelter plant (aluminium segment) for manufacture of aluminium. Also, thermal power is transferred from the captive power plant (aluminium segment) to the refinery (chemical segment). In the books of accounts, transfer of alumina and power is recorded at the moving average price as per Ind AS 2, 'Inventories'. However, for the purpose of segment reporting, the entity considers the average export realisation and average purchase price from the state grid as the inter-segment transfer prices of alumina and power, respectively.

Is the entity required to consider the cost as recorded in the books of accounts as the inter-segment transfer price of alumina and power in its segment reporting as per Ind AS 108, 'Operating Segments'?

View:

For the purpose of segment reporting as per Ind AS 108, disclosure of the amount of each segment item that is reported should be based on the information provided to the CODM for the purpose of making decisions about allocation of resources to the segment and for assessing its performance.

Accounting treatment of expenditure relating to employee benefit expenses, rent expenses, travelling expenses and house-keeping expenses which are compulsorily required to be incurred for construction of the project

Facts and query:

The company is incorporated and engaged in the creation of a self-constructed asset, i.e. a bullet train project. The querist has sought the opinion of the committee on the accounting treatment of expenditure relating to employee benefit expenses, rent expenses, travelling expenses and house-keeping expenses which are compulsorily required to be incurred for the construction of the rail project by the company.

View:

The capitalisation of an item of cost to a fixed asset/project depends upon the nature of such expenses in relation to the construction/acquisition activity in the context of requirements in this regard laid down in the applicable Ind ASs. The basic principle to be applied while capitalising an item of cost to a property, plant and equipment (PPE) is that it is directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. The committee stated that just because the only activity being undertaken by the company at present is the construction of the rail project, this does not mean that all the costs incurred by the company are directly attributable costs of the rail project in accordance with the requirements of Ind AS 16. The committee is of the view that 'directly attributable' costs are generally such costs which are necessary to enable the construction activity, i.e. these costs are directly related to the construction activity and without the incurrence of which the asset cannot be brought to the location and condition necessary for it to be capable of operating in the manner intended by management. Accordingly, the committee opined that the expenditure on employee benefits, rent expenses, travelling expenses and housekeeping expenses incurred by the company can be capitalised only if these can be considered as directly attributable cost to bringing the rail project or the related asset(s) to the location and the condition necessary for it (them) to be capable of operating in the manner intended by the management.

Deferred tax under Ind AS 12 on fair value changes of investments

Facts and query:

The company is a diversified oil and gas public sector undertaking. It holds equity shares of listed companies as non-current investments. These investments are measured at fair value other comprehensive income. In Union Budget 2018–2019, GoI re-introduced long-term capital gain arising on transfer/sale of equity shares in a company at the rate of 10% on profit exceeding INR 1 lakh from the sale of specified securities held for over one year (under section 112A of the Income-tax Act subject to exemptions as provided under the said section). The long-term capital gain tax is payable only on the sale of equity shares on or after 1 April 2018.

The querist sought the EAC's views on accounting of deferred tax arising on fair value changes in such investments.

View:

The EAC opined that

- Ind AS 12 is applicable on fair value changes of equity investments including those covered under section 112A and the tax effect is required to be given in respect of all investments which are held as at 31 March 2018.
- The company should recognise deferred tax asset on long-term capital loss under section 112A of the Income-tax Act only if it has reasonable certainty about taxable income/gain that would arise in future that can be set off against the unabsorbed capital loss within the prescribed time period. For this purpose, the company should consider, amongst others, future reversal of existing taxable temporary differences (e.g. future capital gains against which the long-term capital loss can be set off, existing carried forward long-term capital losses) and tax planning opportunities.
- The deferred tax liability or asset shall be computed separately for individual investments since the cost of acquisition and the fair value at the reporting date for each investment may vary and, resultantly, the tax base and temporary difference for each individual investment would vary. Further, the company should consider the relevant tax provisions, interpretations and legal pronouncements, including the criteria provided in Ind AS 12 for offsetting deferred tax assets and deferred tax liabilities.
- The deferred tax charge or income resulting from fair value remeasurement of investments that are designated at fair value through other comprehensive income (FVOCI) under Ind AS 109 shall be recognised directly in OCI since the fair value remeasurement is also recognised in OCI.

Financial Reporting Review Board (FRRB)

Common errors found by the FRRB in the implementation of AS 5: Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies and AS 9: Revenue Recognition

The FRRB has published an article in the ICAI journal of October 2019 on non-compliances observed with respect to AS 5 and AS 9. Amongst others, the observations included:

i. Certain items of expenditure have been directly debited to reserves and surplus.

ii. Non-disclosure of nature of prior period items.

iii. Sundry balances written off were wrongly disclosed under prior period adjustments.

iv. Incorrect presentation of certain items as an exceptional item in the statement of profit and loss. These included gain on finance lease arrangements, write back of compensation under the employee stock option scheme, foreign exchange fluctuation difference, gain on payment of foreign currency convertible bonds, and tax impact on credit/charge in respect of exceptional items.

v. Recognition of revenue on receipt basis: Revenue from sales of tickets should be recognised as per the completed contract method. Tickets are generally sold before the event takes place. Accordingly, in case of advance booking of tickets, there is always a time gap between the sale of tickets and actual event. Hence, such revenue cannot be considered to have been earned until and unless the event has taken place. If the event doesn't take place, it may be necessary even to refund the amount. The same principle is applicable to income from advertising as well.

vi. Timing of revenue recognition w.r.t. insurance claims: The FRRB noted that insurance claims do not fall within the definition of 'revenue' as given in AS 9. However, it was viewed that as in the case of sale of goods or rendering of services, the recognition of insurance claims also requires that the amount realisable is measurable and it is not unreasonable to expect ultimate collection. Accordingly, recognising insurance claims at the time of filing the claims with the insurance company without considering the uncertainty relating to its measurability is not appropriate.

vii. FRRB observed that dividend was being accounted on an as and when received basis rather than when the right to receive payment is established.

Common errors found by the FRRB in the Implementation of AS 22: Accounting for Taxes on Income

The FRRB has published an article in the ICAI journal of August 2019 on non-compliances observed by it with respect to AS 22. Amongst others, the observations included:

1. Offsetting of deferred tax asset and deferred tax liability in the consolidated financial statement. Deferred tax asset and deferred tax liability can be offset against each other, only when the enterprise has a legally enforceable right to set them off against each other. The FRRB observed that in consolidated financial statements, certain entities had reported a net deferred tax asset by adjusting the deferred tax asset of one enterprise against the deferred tax liability of another enterprise. Since there is no legally enforceable right to offset the deferred tax asset of one enterprise against the deferred tax liability of another enterprise, reporting of such balances on net basis is not in accordance with AS 22.
2. As per AS 22, deferred tax liability should be disclosed separately after the head 'Unsecured loans' and deferred tax asset should be disclosed separately after the head 'Investments' on the face of the balance sheet. The FRRB noted that certain companies were not following the said presentation requirement.
3. Non-disclosure of major components of deferred tax asset and deferred tax liability.
4. Non-recognition of deferred tax asset and deferred tax liability in case of losses. Deferred tax liability recognised at the balance sheet date gives rise to future taxable income at the time of reversal. Accordingly, deferred tax assets to the extent of deferred tax liability should be recognised.
5. Virtual certainty is not supported by convincing evidence. A projection of the future profits made by an enterprise cannot, in isolation, be considered as convincing evidence. Further, that evidence should be available at the reporting date in a concrete form, e.g. a profitable binding export order.

Ind AS Technical Facilitation Group (ITFG)

Clarification bulletin 20 and 21

ITFG issued its bulletin 20 which covered, among other issues, consolidation by an investment entity, accounting by an investor in its separate financial statements when one associate transfers a business undertaking to another associate, and application of equity method in preparation of consolidated financial statements.

The ITFG also issued its bulletin 21 which addressed issues related to the implementation of the new lease standard, Ind AS 116. Amongst others, the bulletin addresses the applicability of short-term lease exemption, accounting of rent equalisation liability on transition to Ind AS 116, application of Ind AS 116 to leases acquired in a business combination by a first-time adopter of Ind AS, and accounting of exchange differences arising on lease liability.

Refer to: https://resource.cdn.icai.org/55591asbicai-itfgcb20.pdf and https://resource.cdn.icai.org/56773indas46019.pdf for the ITFG bulletins

Clarification bulletin 22 and 23

In bulletin 22, the ITFG dealt with several queries raised by stakeholders. These included queries on application of short-term lease recognition exemption under Ind AS 116, lessor's accounting under Ind AS 116 for operating leases with scheduled escalations in line with the general inflation, accounting for gifts distributed by pharmaceutical companies to doctors, restatement of comparatives in a common control business combination with an 'appointed date' specified in the Court Scheme from both the transferor and transferee perspective and requirement to present a third balance sheet as at the beginning of the earliest period presented by a transferee due to restatement of comparatives on account of common control business combination.

The ITFG further issued its bulletin 23 which deals with the accounting implications of the Taxation Laws (Ordinance), 2019.

Refer to: https://resource.cdn.icai.org/57122asbitfgcn22.pdf and https://resource.cdn.icai.org/57299asbitfgcn23.pdf

Securities and Exchange Board of India (SEBI)

Disclosures by listed entities of defaults on payment of interest/repayment of principal amount on loans from banks/financial institutions and unlisted debt securities (Circular No. SEBI/HO/CFD/CMD1/CIR/P/2019/140 dated 21 November 2019)

The SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (SEBI LODR Regulations), currently require disclosure of material events/information by listed entities to stock exchanges. Specific disclosures are required under the SEBI LODR Regulations in certain matters such as delay/default in payment of interest/principal on debt securities such as non-convertible debts (NCDs) and non-convertible redeemable preference shares (NCRPS). It has been observed that similar disclosures are generally not made by listed entities with respect to loans from banks and financial institutions.

Corporates in India are even today primarily reliant on loans from the banking sector. Many banks and financial institutions are presently under considerable stress on account of large loans to the corporate sector turning into stressed assets/non-performing assets (NPAs). Some companies have also been taken up for initiation of insolvency and bankruptcy proceedings.

In order to address this critical gap in the availability of information to investors, listed entities shall comply with the requirements of this circular. To begin with, listed entities shall make disclosure of any default on loans, including revolving facilities like cash credit, from banks/financial institutions which continue beyond 30 days.

Such disclosure shall be made promptly, but not later than 24 hours from the 30th day of such default. In case of unlisted debt securities, i.e. NCDs and NCRPS, the disclosure shall be made promptly but not later than 24 hours from the occurrence of the default.

The disclosure as applicable in terms of this circular shall be made beginning on 1 January 2020.

SEBI Board Meeting (PR No 24/2019 dated 20 November 2019)

SEBI in its board meeting dated 20 November 2019 took the following decisions:

1. Issuance of SEBI (Portfolio Managers) Regulations, 2019

   SEBI had constituted a working group to review the SEBI (Portfolio Managers) Regulations, 1993, to suggest steps to be taken to safeguard the interest of investors and development of the investment product. The board, after considering the recommendations of the working group, public comments received and proposals made thereon for amendment to the extant SEBI (Portfolio Managers) Regulations, approved the issuance of SEBI (Portfolio Managers) Regulations, 2019.

2. Review of rights issue process

   The board has approved the proposals with respect to the rights issue process and consequential amendments to the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (ICDR Regulations) , and SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR Regulations), with the objective of significantly reducing the timeline for the completion of the rights issue, as well as introducing the dematerialisation and trading of rights entitlements (REs).

3. Extension of business responsibility reporting to the top one thousand listed entities by market capitalisation

   LODR Regulations require that the top five hundred listed entities based on market capitalisation, as on March 31 of every financial year, shall include business responsibility reporting (BRR) as part of their annual reports. The board, upon deliberations, approved a proposal to extend the applicability of BRR to top one thousand listed entities.

Ministry of Corporate Affairs (MCA)

Companies (Meetings of Board and its Powers) Second Amendment Rules, 2019

The MCA issued the amendment rules on 18 November 2019. The rules revise the transaction thresholds within which the board of directors may authorise a related party transaction without requiring approval of the shareholders by way of a resolution.

- For a contract or arrangement in relation to a sale, purchase or supply of any goods or material, a new threshold is fixed at 10% or more of the turnover of the company.
- For a contract or arrangement for selling or otherwise disposing of, or buying, property of any kind, the new threshold is fixed at 10% or more of the net worth of the company.
- For a contract or arrangement in relation to leasing of property of any kind, and in relation to availing or rendering of any services (directly, or through the appointment of an agent), the new threshold is fixed at 10% or more of turnover of the company.

Previously, the thresholds included a monetary cap of INR 100 crore/INR 50 crore which have been removed.

Clarification on appointed date to be specified in scheme of mergers/amalgamation

The MCA has issued a circular clarifying the meaning of the appointed date mentioned in a scheme of merger/ amalgamation. The Companies Act, 1956, did not contain any provision relating to the appointed date. In the case of Marshall & Sons, the Supreme Court held that every scheme of amalgamation has to provide a date from which such scheme shall take effect. The Companies Act, 2013, contains a specific provision under section 232(6), prescribing that a scheme should indicate an appointed date from which it shall be effective.

In response to queries received, the MCA clarified as follows:

- The appointed date may be a specified calendar date or may be tied to the occurrence of an event or fulfilment of any preconditions, as agreed upon between the parties, etc., which are relevant to the scheme.
- The appointed date shall also be deemed as the 'acquisition date' and the date of transfer of control for the purpose of accounting as per Ind AS 103.
- Further, an appointed date can be a date preceding the filing of the scheme application with the National Company Law Tribunal (NCLT). In case the appointed date precedes the date of filing the application with the NCLT by more than one year, specific justification shall be required to be brought out in the scheme, and it should not be against public interest.
- If an event-based appointed date could trigger post filing of certified copy of NCLT order with the Registrar of Companies (RoC), an intimation regarding the triggering of such an event shall also be required to be filed with the RoC within 30 days of the scheme coming into force.

The Companies (Amendment) Bill, 2019

The President of India has approved the Companies (Amendment) Bill, 2019, which further amends the Companies Act, 2013 (the Act). The Companies (Amendment) Bill, 2019 was published in the Official Gazette on 31 July 2019 as the Companies (Amendment) Act, 2019 (the Amendment Act). The Amendment Act has taken into consideration the amendments that were originally notified in the Companies (Amendment) Ordinance, 2018, which was promulgated by the President on 2 November 2018, and then retained in effect through the Companies (Amendment) Ordinance Act, 2019, and the Companies (Amendment) Second Ordinance, 2019, promulgated by the President on 12 January 2019 and 21 February 2019, respectively. Further, the Amendment Act has brought about other key changes which are as follows:

- Doing away with the prerequisite of registering the prospectus with the registrar (in case of a public offer) to only a filing requirement.
- Extending the possibility of mandating dematerialisation of securities even to private limited companies by providing requisite powers to the Central Government.
- Specific responsibility cast on companies to identify significant beneficial owners (SBOs).
- Stricter enforcement of compliance with corporate social responsibility (CSR) provisions and introduction of penal clause.

Ministry of Finance

Taxation Laws (Amendment) Act, 2019

On 20 September 2019, the government announced a fiscal stimulus in the form of major tax changes, reducing the corporate income tax rate of domestic companies to, inter alia, attract investment, generate employment and boost the economy of the country. As the Parliament was not in session and because of the urgency in the matter, the ordinance was promulgated. On 25 November 2019, the government introduced the Taxation Laws (Amendment) Bill, 2019 (the Bill), in the Parliament, to replace the ordinance. The bill is in line with the ordinance. However, considering the representations received from various stakeholders and to provide certainty, certain additional amendments have been proposed to the Income-tax Act, 1961, and the Finance Act, 2019. The bill was passed by the Parliament and received presidential assent on 11 December 2019.

For further details, refer to: https://www.pwc.in/assets/pdfs/news-alert-tax/2019/pwc_news_alert_27_november_2019_taxation_laws_amendment_bill_2019.pdf

Financial Accounting Standards Board

Accounting Standards Update (ASU) 2019-12

On 18 December 2019, the FASB issued ASU 2019-12, Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes (the ASU), as part as part of its overall simplification initiative to reduce the costs and complexity of applying accounting standards while maintaining or improving the usefulness of the information provided to users of financial statements. The FASB's amendments primarily impact ASC 740, Income Taxes, and may impact both interim and annual reporting periods.

For further details, refer to: https://www.pwc.com/us/en/cfodirect/assets/pdf/in-depth/us2019-19-fasb-simplifies-income-taxes-asc-740.pdf

ASU 2019-11

On 26 November 2019, the FASB issued ASU 2019-11, Codification Improvements to Topic 326, Financial Instruments—Credit Losses. This ASU amends guidance originally introduced or amended by ASU 2016-13, Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The amendments include:

- new guidance related to expected recoveries for purchased financial assets with credit deterioration
- transition relief relating to troubled debt restructurings
- additional disclosure relief related to accrued interest
- clarification related to the application of the practical expedient for financial assets secured by collateral maintenance provisions.

For further details, refer to: https://www.pwc.com/us/en/cfodirect/assets/pdf/in-depth/us2019-21-fasb-cecl-amendments.pdf

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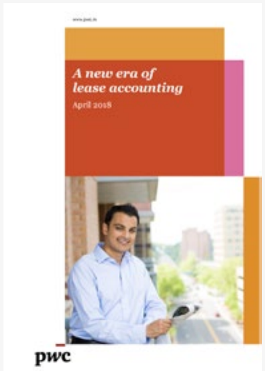

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