Ind AS Transition Facilitation Group (ITFG) Clarification Bulletin 10

'*Ind AS Transition Facilitation Group' (ITFG) of Ind AS Implementation Committee has been constituted for providing clarifications on timely basis on various issues related to the applicability and /or implementation of Ind AS under the Companies (Indian Accounting Standards) Rules, 2015, raised by preparers, users and other stakeholders. Ind AS Transition Facilitation Group (ITFG) considered some issues received from members and decided to issue following clarifications*[1] *on July 5, 2017:*

Issue 1: A Ltd. has given an interest free loan to its subsidiary company B Ltd. Both companies are covered under Phase I of Ind AS roadmap. B Ltd. has recognised the differential of present value of loan amount and its carrying amount as per previous GAAP as 'Equity' in its standalone financial statements prepared as per Ind AS. A Ltd. has elected to measure the investment in subsidiary at its previous GAAP carrying amount at that date in accordance with paragraph D15 of Ind AS 101, *First-time Adoption of Indian Accounting Standards*.

What will be the accounting treatment of the differential in the carrying value of loan under previous GAAP and its present value in the standalone financial statements of A Ltd. prepared as per Ind AS?

Response: Paragraphs D14 and D15 of Ind AS 101 state as follows:

"D14 When an entity prepares separate financial statements, Ind AS 27 requires it to account for its investments in subsidiaries, joint ventures and associates either:
(a) at cost; or
(b) in accordance with Ind AS 109."

D15 If a first-time adopter measures such an investment at cost in accordance with Ind AS 27, it shall measure that investment at one of the following amounts in its separate opening Ind AS Balance Sheet:

(a) cost determined in accordance with Ind AS 27; or

b) deemed cost. The deemed cost of such an investment shall be its:

(i) fair value at the entity's date of transition to Ind ASs in its separate financial statements; or

(ii) previous GAAP carrying amount at that date.

[1] Clarifications given or views expressed by the Ind AS Transition Facilitation Group (ITFG) represent the views of the members of the ITFG and are not necessarily the views of the Ind AS Implementation Committee or the Council of the Institute. The clarifications/views are based on the accounting principles as on the date the Group finalises the particular clarification. The date of finalisation of each clarification is indicated along with the clarification. The clarification must, therefore, be read in the light of any amendments and/or other developments subsequent to the issuance of clarifications by the Group

A first-time adopter may choose either (i) or (ii) above to measure its investment in each subsidiary, joint venture or associate that it elects to measure using a deemed cost."

Paragraph 10 of Ind AS 101 states as follows:

Except as described in paragraphs 13–19 and Appendices B–D, an entity shall, in its opening Ind AS Balance Sheet:

(a) recognise all assets and liabilities whose recognition is required by Ind ASs;

(b) not recognise items as assets or liabilities if Ind ASs do not permit such recognition;

(c) reclassify items that it recognised in accordance with previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity in accordance with Ind ASs; and

(d) apply Ind ASs in measuring all recognised assets and liabilities.

In accordance with the above, it may be noted that if the entity exercises the option under D15 (b) (ii) to measure the investment in subsidiary at previous GAAP carrying amount, then the differential in the carrying value of the loan under previous GAAP and present value shall be added to the investment in subsidiary measured at cost as required by paragraph 10 of Ind AS 101.

Issue 2: X Ltd. is a first-time adopter of Ind AS from financial year 2016-17. It had taken 6 year term loan in April 2010 from bank and paid processing fees at the time of sanction of loan. The term loan is disbursed in different tranches from April 2010 to April 2016. On the date of transition to Ind AS, i.e. 1.4.2015, it has calculated the net present value of term loan disbursed upto 31.03.2015 by using effective interest rate and proportionate processing fees has been adjusted in disbursed amount while calculating net present value. What will be the accounting treatment of processing fees belonging to undisbursed term loan amount?

Response: Assuming that the undisbursed loan amount will be disbursed in future, the accounting treatment of the processing fees will be as follows:

Appendix A of Ind AS 109, *Financial Instruments*, defines 'Effective interest method' as follows:

"The rate that exactly discounts 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****. When calculating the effective interest rate, an entity shall estimate the expected cash flows by considering all the contractual terms of the financial instrument (for example, prepayment, extension, call and similar options) but shall not consider the* ***expected credit losses****. 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 (see paragraphs B5.4.1–B5.4.3),* ***transaction costs****, and all other premiums or discounts. There is a presumption that the cash flows and the expected life of a group of similar financial instruments can be estimated reliably. However, in those rare cases when it is not possible to reliably estimate the cash flows or the expected life of a financial instrument (or group of financial instruments), the entity shall use the contractual*

cash flows over the full contractual term of the financial instrument (or group of financial instruments)."

Paragraph B5.4.1 of Ind AS 109, *Financial Instruments***,** states as follows*:*

"In applying the effective interest method, an entity identifies fees that are an integral part of the effective interest rate of a financial instrument. The description of fees for financial services may not be indicative of the nature and substance of the services provided. Fees that are an integral part of the effective interest rate of a financial instrument are treated as an adjustment to the effective interest rate, unless the financial instrument is measured at fair value, with the change in fair value being recognised in profit or loss. In those cases, the fees are recognised as revenue or expense when the instrument is initially recognised."

Further, Paragraph B5.4.2 of Ind AS 109, *inter-alia* states that, "*fees that are an integral part of the effective interest rate of a financial instrument include:*

(a) origination fees received by the entity relating to the creation or acquisition of a financial asset. Such fees may include compensation for activities such as evaluating the borrower's financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating the terms of the instrument, preparing and processing documents and closing the transaction. These fees are an integral part of generating an involvement with the resulting financial instrument."

In accordance with the above, the processing fee is an integral part of the effective interest rate of a financial instrument and shall be included while calculating the effective interest rate.

It may be noted that to the extent there is evidence that it is probable that the undisbursed term loan will be drawn down in the future the processing fee is accounted for as a transaction cost under Ind AS 109, i.e., the fee is deferred and deducted from the carrying value of the financial liabilities when the draw down occurs and considered in the effective interest rate calculations. However, if it is not probable that the undisbursed term loan will be drawn down in the future then the fees is recognised as an expense on a straight- line basis over the term of the loan.

Accordingly, in the given case, assuming that the undisbursed loan amount will be disbursed in future, the entire processing fees, i.e. processing fee pertaining to the disbursed as well as to the undisbursed loan amount will be included, while calculating the effective interest rate of the loan at the date of transition to Ind AS and is recognised as an expense over the term of the loan

Issue 3: A Ltd. has two subsidiaries B Ltd. and C Ltd. and is required to comply with Ind AS from 1st April, 2017. In August 2015, B Ltd. and C Ltd. got amalgamated and as a result of the amalgamation, goodwill has been created in the separate financial statements of the amalgamated entity. The entity has decided to not restate its past

business combinations in accordance with the exemption available under Ind AS 101, *First-time Adoption of Indian Accounting Standards*. This goodwill is allowed as deduction under Income tax laws in the books of the amalgamated entity. In the consolidated financial statements of A Ltd., such accounting goodwill gets eliminated as a result of consolidation adjustment. However, there is an increase in the tax base of assets in the consolidated financial statements of A Ltd. resulting from such tax deductible goodwill.

Whether deferred tax asset on the tax deductible goodwill should be recognised in the consolidated financial statements of A Ltd. prepared as per Ind AS when there is no corresponding accounting goodwill in the consolidated financial statements of A Ltd.?

Response: Paragraph 5 of Ind AS 12, *Income Taxes, states that , the tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes*

Further, paragraph 7 of Ind AS 12 states that, *"The tax base of an asset is the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to an entity when it recovers the carrying amount of the asset. If those economic benefits will not be taxable, the tax base of the asset is equal to its carrying amount."*

Further, paragraph 11 of Ind AS 12, *inter alia*, states that, the tax base is determined by reference to the tax returns of each entity in the group.

Accordingly, in the given case, the tax base of the goodwill will be the amount that will be allowed as deduction in future in accordance with the Income Tax Act, 1961.

Paragraph 9 of Ind AS 12, states as follows:

"Some items have a tax base but are not recognised as assets and liabilities in the balance sheet. For example, preliminary expenses are recognised as an expense in determining accounting profit in the period in which they are incurred but may not be permitted as a deduction in determining taxable profit (tax loss) until a later period(s). The difference between the tax base of the preliminary expenses, being the amount permitted as a deduction in future periods under taxation laws, and the carrying amount of nil is a deductible temporary difference that results in a deferred tax asset."

In accordance with the above, a deferred tax asset may be created for assets or liabilities having a tax base but nil carrying amount in the financial statements.

As per paragraph 24 of Ind AS 12, "*A deferred tax asset shall be recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised, unless the deferred tax asset arises from the initial recognition of an asset or liability in a transaction that:*

(a) is not a business combination; and

(b) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).

However, for deductible temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, a deferred tax asset shall be recognised in accordance with paragraph 44."

Accordingly, in the given case, deferred tax asset on the tax base of goodwill should be recognised in accordance with Ind AS 12 by crediting the consolidated statement of profit and loss, to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised, in the consolidated financial statements of A Ltd. Additionally, this will not qualify for the initial recognition exemption under paragraph 24 of Ind AS 12 as there is no initial recognition of an asset or liability arising from the amalgamation of subsidiaries in the consolidated financial statements A Ltd (the impact of amalgamation of subsidiaries is eliminated in the consolidated financial statements of A Ltd).

Issue 4: Company X is a first-time adopter of Ind AS from the financial year 2017-18 with the transition date being 1 April 2016. On 1 January 2016, Company X has classified a group of assets as 'Assets held for sale' in accordance with AS 10, *Property, Plant and Equipment* and stated it at lower of their net book value and net realisable value under previous GAAP. Company X has presented these assets separately from other fixed assets in the previous GAAP financial statements for the year ended 31 March 2016 and did not provide depreciation subsequently on the same.

On transition to Ind AS, these assets could not fulfil the criteria for classifying as held for sale in accordance with Ind AS 105, *Non-current Assets Held for Sale and Discontinued Operations* and accordingly, would be reclassified as 'Property, plant and equipment'.

Whether deemed cost exemption under paragraph D7AA of Ind AS 101 will be available for these assets?

Response: Under previous GAAP, i.e., AS 10, *Property, Plant and Equipment*, the Company X presented items of fixed assets retired from active use and held for sale separately. In this regard, paragraphs 73 and 74 of AS 10 may be noted:

"73 Items of property, plant and equipment retired from active use and held for disposal should be stated at the lower of their carrying amount and net realisable value. Any write-down in this regard should be recognised immediately in the statement of profit and loss.

74 The carrying amount of an item of property, plant and equipment should be derecognised

(a) on disposal; or

(b) when no future economic benefits are expected from its use or disposal."

In accordance with the above, it may be noted that such fixed assets are shown separately and are not derecognised from financial statements; these are eliminated from the financial statements only if they are disposed off or no future economic benefits are expected from its use or disposal.

Paragraph D7AA of Ind AS 101, *First-time Adoption of Indian Accounting Standards,* provides that, *"Where there is no change in its functional currency on the date of transition to Ind ASs, a first-time adopter to Ind ASs may elect to continue with the carrying value for all of its property, plant and equipment as recognised in the financial statements as at the date of transition to Ind ASs, measured as per the previous GAAP and use that as its deemed cost as at the date of transition after making necessary adjustments in accordance with paragraph D21 and D21A, of Ind AS 101."*

In accordance with above, the exemption as per paragraph D7AA is available to all property, plant and equipment as recognised in the financial statements as at the date of transition to Ind AS irrespective of whether these were disclosed separately. Under the previous GAAP, Company X has only presented the assets as held for sale separately. Accordingly, the Company X can avail the deemed cost exemption for such type of assets which were presented separately as held for sale as per previous GAAP but on transition did not meet the criteria of assets held for sale given under Ind AS 105, *Non-current Assets Held for Sale and Discontinued Operations*.

Issue 5: MNC Ltd. is a first-time adopter of Ind AS. It had availed the option given under paragraph 46/46A of AS 11, *The Effects of Changes in Foreign Exchange Rates* notified under the Companies (Accounting Standards) Rules, 2006. MNC Ltd. has opted for the exemption given under paragraph D13AA of Ind AS 101, *First-time Adoption of Indian Accounting Standards* and accordingly, debited exchange differences arising from translation of long term foreign currency monetary items to Foreign Currency Monetary Item Translation Difference Account.

Whether the amount debited to Foreign Currency Monetary Item Translation Difference Account is required to be reduced from profit or loss from continuing operations for the purpose of calculating basic earnings per share (EPS) as per paragraph 12 of Ind AS 33, *Earnings per Share*?

Response: Paragraph 12 of Ind AS 33 states as follows:

"For the purpose of calculating basic earnings per share, the amounts attributable to ordinary equity holders of the parent entity in respect of:

(a) profit or loss from continuing operations attributable to the parent entity; and

(b) profit or loss attributable to the parent entity

shall be the amounts in (a) and (b) adjusted for the after-tax amounts of preference dividends, differences arising on the settlement of preference shares, and other similar effects of preference shares classified as equity.

Where any item of income or expense which is otherwise required to be recognised in profit or loss in accordance with Indian Accounting Standards is debited or credited to securities premium account/other reserves, the amount in respect thereof shall be deducted from profit or loss from continuing operations for the purpose of calculating basic earnings per share."

In accordance with the above, it is pertinent to note that the above paragraph refers to those items of income or expense which as per Ind AS would have been required to be recognised in profit or loss but are recognised in securities premium account/other reserves.

Accordingly, the exchange differences arising from translation of long term foreign currency monetary items that are debited to Foreign Currency Monetary Translation Reserve Account as per paragraph 46/46A of AS 11 is an option available under Ind AS.

Accordingly, exchange differences that are being debited to Foreign Currency Monetary Item Translation Difference Account is in accordance with Ind AS and therefore, the same is not required to be reduced from profit or loss from continuing operations for the purpose of calculating basic earnings per share.

Issue 6: Company X participated in a customer loyalty programme operated by a third party. Under the programme, members earn points for purchases made in X's stores. The members can redeem the accumulated award points for goods supplied by the third party. X has fulfilled its obligation to programme members once the members have been granted points when making purchases in its stores. The obligation to supply the redeemed goods lies with the third party. At the end of 31 March 2017, X has granted award points with an estimated fair value of INR 20,000 and owes the third party INR 17,000.

In the above situation, what should be the classification of the expense of providing free third party goods i.e. in the above example, should INR 17,000 be:

- **classified as changes in inventories of finished goods, stock in trade and WIP or**
- **classified as marketing expense or**
- **reduced from revenue?**

Response: Paragraph 8 of Appendix B, *Customer Loyalty Programmes* of Ind AS 18, *Revenue* states as follows:

"8 If a third party supplies the awards, the entity shall assess whether it is collecting the consideration allocated to the award credits on its own account (ie as the principal in the transaction) or on behalf of the third party (ie as an agent for the third party).

(a) If the entity is collecting the consideration on behalf of the third party, it shall:

(i) measure its revenue as the net amount retained on its own account, ie the difference between the consideration allocated to the award credits and the amount payable to the third party for supplying the awards; and

(ii) recognise this net amount as revenue when the third party becomes obliged to supply the awards and entitled to receive consideration for doing so. These events may occur as soon as the award credits are granted. Alternatively, if the customer can choose to claim awards from either the entity or a third party, these events may occur only when the customer chooses to claim awards from the third party.

(b) If the entity is collecting the consideration on its own account, it shall measure its revenue as the gross consideration allocated to the award credits and recognise the revenue when it fulfils its obligations in respect of the awards."

In accordance with the above, if the entity is acting as a principal then it shall recognise the revenue at gross amount and the expense of providing free third party goods will be included in the cost of goods sold.

If the entity is acting as an agent, then in accordance with paragraph 8(a)(i), it shall measure its revenue at the net amount, i.e. the difference between the consideration allocated to the award credits and the amount payable to the third party.

Accordingly, in the given case the entity will assess based on facts and circumstances as to whether it is acting as an agent or principal. If it is determined that Company X is acting as an agent, then entity will recognise commission income of INR 3,000. If it is determined that Company X is acting as a principal, then company X shall recognise revenue of INR 20,000 and INR 17,000 shall be charged to the Statement of Profit & Loss as cost of goods sold

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