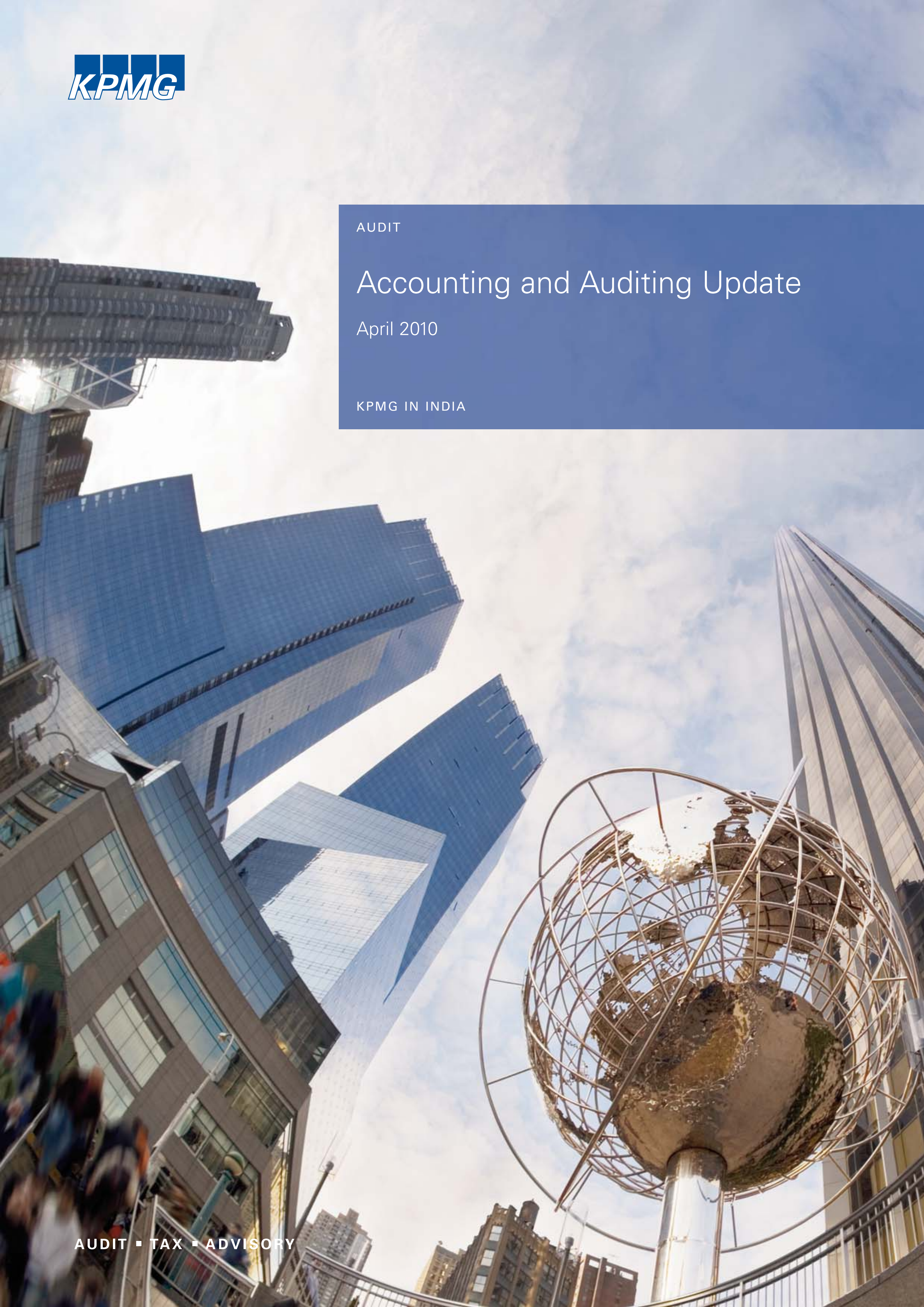


AUDIT

Accounting and Auditing Update

April 2010

KPMG IN INDIA

AUDIT ▪ TAX ▪ ADVISORY

Editorial

It is with great pleasure we bring forth the April edition of the Accounting and Auditing Update.

As India marches towards implementing IFRS in 2011, two equally daunting challenges are apparent. Firstly, would it be realistic to expect that regulators will be able to carry out due deliberations and consider comments from all the affected parties prior to issuing so many converged standards within a short span of one year. If we go by history, standard setting around the world is a long process and takes several months, and frequently years, to issue a single accounting standard.

Secondly, is Corporate India really prepared to adopt IFRS? Planning for IFRS goes beyond technical accounting. It involves responding to the training and change management needs, determining the needs to use external IFRS consultants, re-engineering company's processes, technology, internal controls and income-tax structures. The exposure draft on AS 1, *Presentation of Financial Statements* discussed in this publication would highlight the need for elaborate systems to meet the ever increasing disclosures required under the new era. Clearly the clock is ticking!

The recent amendments to Clause 41 of the equity listing agreement by the Securities and Exchange Board of India are welcome steps in the right direction. The availability of an option to submit consolidated IFRS financial statements in lieu of consolidated Indian GAAP financial statements is clearly a landmark development. This, apart from giving a lead time to the listed entities to voluntarily prepare for the April 2011 deadline, also, in a way, provides an assurance that IFRS is going to be an irrevocable reality in India. In this issue, we have attempted to summarise some of the implementation issues arising from the amendment.

The time, cost, complexity and the impact of adopting IFRS would vary from one standard to the other. Particularly, accounting for business combinations is expected to undergo a fundamental transformation upon IFRS convergence. The existing court rules driven accounting framework are bound to be tested in areas such as – What is the date of acquisition? – Fair value versus book value? – To capitalise or expense transaction costs? – Ignore or account the contingent consideration upfront? In this journal, some of the potential differences have been highlighted.

Cloud computing is a style of computing in which dynamically scalable and often virtualised resources are provided over the Internet. Users instead of owning the infrastructure, could potentially rent the resources. Ability to rent servers, software and storage systems is a boon for start-ups and also raise a valid economic debate of –*Capex versus Opex*. In this journal, we have attempted to discuss some of the next generation's technical challenges.

We hope you enjoy reading this publication. We would look forward to receiving your feedback on what you would like us to cover in our future publications at **aaupdate@in.kpmg.com**

Table of contents

Presentation of

financial statements

ICAI exposure draft of revised Accounting Standard (AS) 1

The path has been laid for a makeover of the traditional Indian GAAP (IGAAP) financial statements to a globally recognised format of presentation. The way in which stakeholders read and analyse IGAAP financial statements is set to change for good, and in our opinion, for the better, making them more consistent and comparable internationally.

Background

There is currently no accounting standard in India which deals with the requirements relating to presentation of financial statements in a comprehensive manner. The presentation of IGAAP financial statements is governed to a limited extent (i.e., to the extent of disclosure of accounting policies) by the current AS 1, *Disclosure of Accounting Policies*, and in detail by various statutes (such as the Companies Act, 1956 for corporate entities) and industry regulations (such as for Banking and Insurance). The Exposure Draft[1] of the Revised AS 1 (the ED / AS – Revised) issued by the Accounting Standards Board of the Institute of Chartered Accountants of India (ICAI) pursuant to the decision to converge with IFRS, helps address this void.

There are no major differences between the ED and International Accounting Standards (IAS) 1, *Presentation of Financial Statements*. However, as compared to the existing AS 1, the ED proposes significant changes to the components of financial statements, including significant additional disclosure and presentation requirements. Compliance with these requirements may call for a review and upgradation of existing IT environments and processes which will need to support information systems required to prepare these financial statements.

The ED prescribes the basis for presentation of general purpose financial statements to ensure comparability both with the entity's financial statements of previous periods (on a go-forward basis) and with the financial statements of other entities. It sets out overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content.

1. ICAI Website, Issued on 28 July 2009

Significant changes

Significant changes proposed by the ED have been discussed below along with our comments on these changes in the Indian context.

- **Explicit and unreserved statement of compliance**

  The ED requires that an entity make an explicit and unreserved statement of compliance with all accounting standards in its financial statements. The ED clarifies that rectification of inappropriate accounting policies either by disclosures of the accounting policies used or by notes or explanatory statements is not allowed. However, in extremely rare circumstances, if management concludes that compliance with an AS will be so misleading that it would conflict with the objective of financial statements (i.e., fair presentation), the entity may depart from that requirement if the regulatory framework requires or does not prohibit such a departure.

- **Components of financial statements**

  Apart from suggesting changes to the titles of the components of the financial statements, (i.e., a Balance Sheet will be referred to as a Statement of Financial Position, a Profit and Loss Account will be referred to as an Income Statement and a Cash Flow Statement will be referred to as a Statement of Cash Flows), the ED proposes the presentation of the following two additional statements in a complete set of financial statements:

(i) Statement of Comprehensive Income (SCI)

This statement presents all items of income and expense recognised in profit or loss, together with all other items of recognised income or expense. An entity may elect to present all items in a single statement or present two linked statements. When an entity elects to present a single statement, that statement is referred to as a Statement of Comprehensive Income and when an entity elects a two statement approach, the statements are referred to as the Income Statement and the Statement of Comprehensive Income. In the two statement approach, the statement of comprehensive income begins with the profit or loss for the period and displays all items included in 'Other Comprehensive Income' (OCI).

OCI comprises those items of income and expenses that are not recognised in the income statement as required or permitted by other accounting standards. Examples of such items are: Changes in revaluation surplus, actuarial gains and losses on defined benefit plans, gains and losses arising from foreign currency translation and gains and losses on cash flow hedges.

Items of OCI may be presented either net of tax effect or before tax effect with one amount presented for the aggregate amount of income tax relating to those components. In either case, the income tax relating to each component of OCI must be disclosed in the SCI or the in the notes.

Reclassification adjustments (i.e., recycling – when amounts previously recognised in OCI are reclassified to the income statement) relating to components of OCI may be presented in the SCI or in the notes.

> The statement of comprehensive income and the statement of changes in equity are two additional concepts introduced by the ED.

(ii) Statement of changes in equity (SOCIE):

This statement presents all owners' changes disclosing:

- amounts of transactions with owners in their capacity as owners;
- total comprehensive income for the period (separately disclosing amounts attributable to controlling and non-controlling interests);
- for each component of equity, the effects of retrospective application or retrospective restatement (refer to the discussion on 'comparative information' below); and
- for each component of equity, a reconciliation between the carrying amount at the beginning and the end of the period, separately disclosing each change.

The amount of dividends recognised as distributions to owners during the period and the related amount per share may be disclosed either in the SOCIE or in the notes.

Dividends will no longer be presented as income statement appropriations, instead, they will be presented in the statement of changes in equity.

Our comments:

- In the SOCIE, all non-owner changes to equity are presented separately from owner changes to equity. We believe that separate presentation is likely contribute to a further understanding of changes in equity resulting from the performance of the entity versus changes in equity resulting from transactions with equity holders acting in that capacity
- An important modification is the inclusion of non-controlling interest (i.e., minority interest) as part of shareholders' funds (or total equity). Current practice in IGAAP is to present minority interest outside of shareholders' funds
- The requirement to disclose income tax relating to each component of OCI has been a subject matter of debate in the past. An argument against such a requirement is that it is not rational to present tax effects on components of OCI differently from the tax effects on individual components of profit or loss. Notwithstanding this argument, since the settled position in IFRS (and also in US GAAP), is to present tax effects, we do not believe that there is any flexibility at this point but to adopt such an approach
- Dividend and other appropriations will not be presented in the income statement, as is the current practice under IGAAP, but will be presented in the SOCIE
- AS 15, Employee Benefits currently requires actuarial gains or losses on defined benefits plans to be recognised in the profit and loss account, whereas the ED provides an option to disclose in OCI. This apparent contradiction is explained by Footnote 1 to the ED which clarifies that "...All existing Accounting Standards and new Accounting Standards which are referred to in this ED are also being revised or formulated, as the case may be, to converge with IFRSs from the aforesaid date. References to the other standards may be viewed accordingly."

- Comparative information:

  The ED proposes the presentation of a statement of financial position at the beginning of the earliest comparative period in when the entity applies an accounting policy retrospectively, makes a retrospective restatement or when it reclassifies items in its financial statements.

Our comments

The ICAI needs to provide clarity on the transitional provisions relating to comparative information to be presented when the first financial statements will be drawn using the 'converged' accounting standards for the periods beginning 1 April 2011. Based on the current position, one would interpret that entities would need to redraw the financial statements for periods beginning 1 April 2010 to provide comparative information for the first 'converged' financial statements.

- Current / non-current classification:

  The ED requires an entity to classify assets and liabilities between current and non-current on the face of the statement of financial position, except when a presentation based on liquidity provides more reliable and relevant information. Whichever method is used, for each asset and liability item that combines amounts expected to be recovered or settled, both before and after 12 months from the reporting date, an entity should disclose the two amounts separately.

Our comments

- Amendments to Schedule VI to the Companies Act, 1956 are on the anvil to synchronise with the above requirements.
- Entities will need to enhance their information systems to separately track amounts that are receivable / payable before and after 12 months from the reporting date to meet the requirements of AS 1 - Revised.
- Entities may need to revisit the computation of key ratios such as current ratio, quick ratio and gearing ratio to help ensure that they are in compliance with debt covenants, etc.

- Extraordinary items:

  The presentation or disclosure of items of income and expense characterised as 'extraordinary items' is specifically prohibited.

Our comments

Note: This is a change from the existing practice under I GAAP. Currently AS 5, *Net Profit or Loss for the Period, Prior period items and Changes in Accounting Policies*, defines extraordinary items as income or expenses that are clearly distinct from ordinary activities and are therefore not expected to recur frequently. Such items are required to be disclosed separately in the profit and loss account with additional disclosure requirements.

- Disclosure of management judgment and sources of estimation uncertainty:

  The ED requires the disclosure of:

  - Judgments made by management in the process of applying an entity's accounting policies; and
  - Major sources of estimation uncertainty at the end of the reporting period that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Our comments

These disclosures will also bring greater transparency in the financial statements and put an additional onus on management when presenting estimates and judgments.

- Capital disclosures:

  The ED requires an entity to disclose information relating to an entity's objectives, policies and processes for managing capital, including compliance with any externally imposed capital requirements.

Our comments

- Schedule VI presently has no such disclosure requirements and we assume this matter will be considered for inclusion in the proposed amendments to the Companies Act
- Our experience indicates that many entities may not have formally documented objectives, policies and processes for managing capital. These would be key changes to the current disclosure practices and would be one of the few implementation challenges for both accountants to prepare and auditors to validate these disclosures.

The Road to Convergence

The ED was issued in July 2009 when the roadmap to convergence with IFRS was driven by a targeted timeline for applicability for accounting periods commencing on or after 1 April 2011. The effective date from when the proposed AS 1 – Revised becomes mandatorily applicable is therefore also driven by similar timelines, i.e., for accounting periods commencing on or after 1 April 2011[2].

However, in January 2010, significant modifications to the convergence roadmap were announced. The Core group constituted by Ministry of Corporate Affairs (MCA) for convergence with IFRS agreed for two sets of accounting standards. The first set would comprise Indian accounting standards converged with IFRS (converged standards) and would apply to specified classes of companies in a phased manner from 1 April 2011 onwards. The second set would comprise the existing Indian accounting standards and would apply to other companies, including Small and Medium Companies ('SMCs'). In March 2010 the MCA announced the roadmap in respect of insurance companies, banking companies and non-banking financial companies where convergence with IFRS would be effective from 1 April 2012 (insurance companies), 1 April 2013 (scheduled commercial banks) and 1 April 2013 / 1 April 2014 (phased manner for NBFCs).

AS 1 – Revised would therefore form part of the converged standards. Accordingly, the entities that fall within the scope of the proposed standard and the effective date of the standard for these entities will need to be modified in the ED to reflect the January 2010 and March 2010 convergence roadmaps.

Further, we understand that ICAI has also identified legal or regulatory changes required (some of which have been discussed above) to give effect to each converged standard. It is expected that necessary changes will be in place in a timely manner, else the converged standards would be overridden by law to the extent of divergence.

2. Announcement by the Ministry of Corporate Affairs (MCA) dated 22 January 2010.

The future of **accounting for business combinations** in India

With far more clarity on the roadmap to convergence with IFRS, stakeholders in India are gearing up to meet the requirements of the new financial reporting standards. The announcement of convergence with IFRS in a phased manner commencing 1 April 2011 has set the accounting, regulatory and legal machinery chugging overtime to set a mechanism in place that would enable the first set of Indian, IFRS-converged financial statements to be issued for periods beginning 1 April 2011.

The Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI) has issued 20 exposure drafts of revised Indian accounting standards that converge with IFRS.

The ICAI's exposure draft on business combinations is awaited - predictably to be issued later than sooner due to the vast and comprehensive changes that it will bring with it. The change, however, is imminent.

Revisions to the existing standards that deal with business combinations in Indian GAAP (IGAAP) mean that changes will be required to long-established accounting treatments and could significantly affect not only the structure of future acquisitions but the acquisition decision itself. This article discusses the changes that a converged Indian accounting standard on business combinations is likely to bring, the new concepts that it will introduce and the impact it will have on future acquisitions in the Indian context. With the objective of delving into these changes and concepts, the current positions under IGAAP and how these positions will change should the authorities issue a standard with a high degree of similarity to IFRS 3 (2008), *Business Combinations*, have been discussed below.

Accounting framework

Under IGAAP, there is no comprehensive standard that deals with all business combinations and neither has the term business combination been defined.

- Accounting Standard (AS) 14, *Accounting for Amalgamations* and certain provisions of the Indian Companies Act, 1956 address accounting for amalgamations, i.e., where an acquiree loses its existence.
- When an entity makes an investment, we apply AS 21, *Consolidated Financial Statements, or AS 23, Accounting for Investments in Associates in Consolidated Financial Statements or AS 27, Financial Reporting of Interests in Joint Ventures*, respectively, in the consolidated financial statements.
- We apply AS 10, *Accounting for Fixed Assets* when a business is acquired on a lump-sum basis.

Thus, under IGAAP, the accounting for a transaction is dependent on the form of the transaction.

IFRS 3 applies to most business combinations –amalgamations, acquisitions and the purchase of a business. The standard, however, does not apply to the formation of a joint venture as the entity does not obtain unilateral control, the acquisition of a group of assets that does not meet the definition of a business and transactions among entities under common control as control in such situations is not transitory.

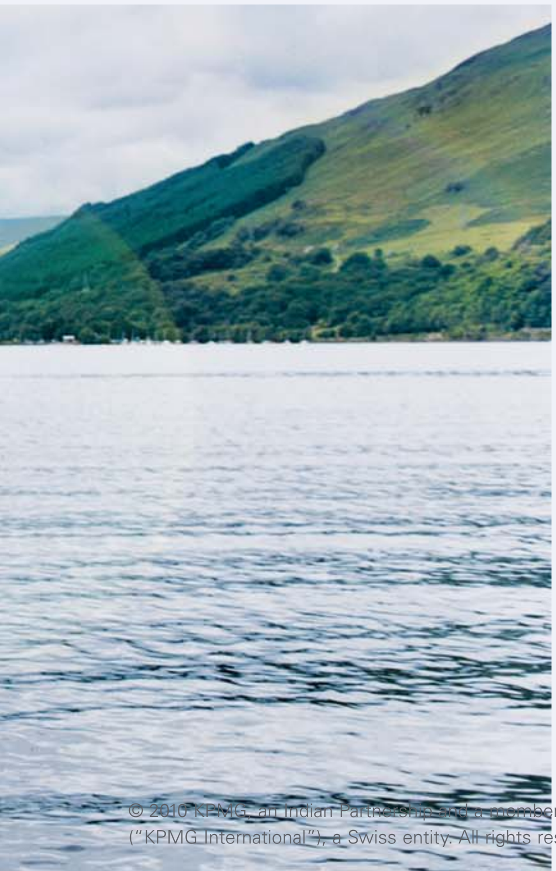
IFRS 3 defines a business combination as *a transaction or other event in which an acquirer obtains control of one or more businesses*. Accordingly, the key elements to identify a business combination are - 'business' and 'control'.

A 'business' generally consists of inputs, processes applied to those inputs and the ability to create outputs. It is not necessary for inputs and processes to be managed as a business at the acquisition date, as long as they are **capable** of being managed for that purpose. 'Control' is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

When an entity acquires a group of assets that do not constitute a business, the transaction is scoped out of IFRS 3. The cost of acquisition in such cases is allocated to the individual assets based on their relative fair values at the date of acquisition. No goodwill or negative goodwill is recognised.

The position under IGAAP could however, be very different. A group of assets and liabilities which do not meet the definition of a business, put together in the shell of a legal entity, could be party to a scheme of amalgamation and qualify for business combination accounting resulting in the recognition of goodwill or capital reserve.

There is a need to look through the structuring of such transactions and recognise that the acquisition of assets and businesses are driven by different economic fundamentals and should therefore, be driven by vastly different accounting requirements.



Potential impact

- Expect the introduction of a comprehensive Indian accounting standard on business combinations
- A common set of accounting principles to be applied to all business combinations help ensure comparability and consistency between transactions as well as between companies internationally
- Fundamental differences between asset acquisitions and business acquisitions will drive their accounting by looking through their structuring to reflect their economic substance.

If the acquired entity is not a business, there can be no business combination, and hence there can be no goodwill.

Method of accounting for business combinations

Under IGAAP amalgamations are accounted for by applying either the purchase method or the pooling of interest method. The latter is allowed if the amalgamation satisfies certain specified conditions. Amalgamations in the nature of purchase are accounted for on the basis of either book value or fair value. The pooling of interest method accounting is done on the basis of book values.

Purchase of shares of another company is accounted for as an investment (in the standalone financial statements) and as a subsidiary/associate/joint venture, as the case may be, in the consolidated financial statements. Acquisition accounting in these cases is done on book value basis.

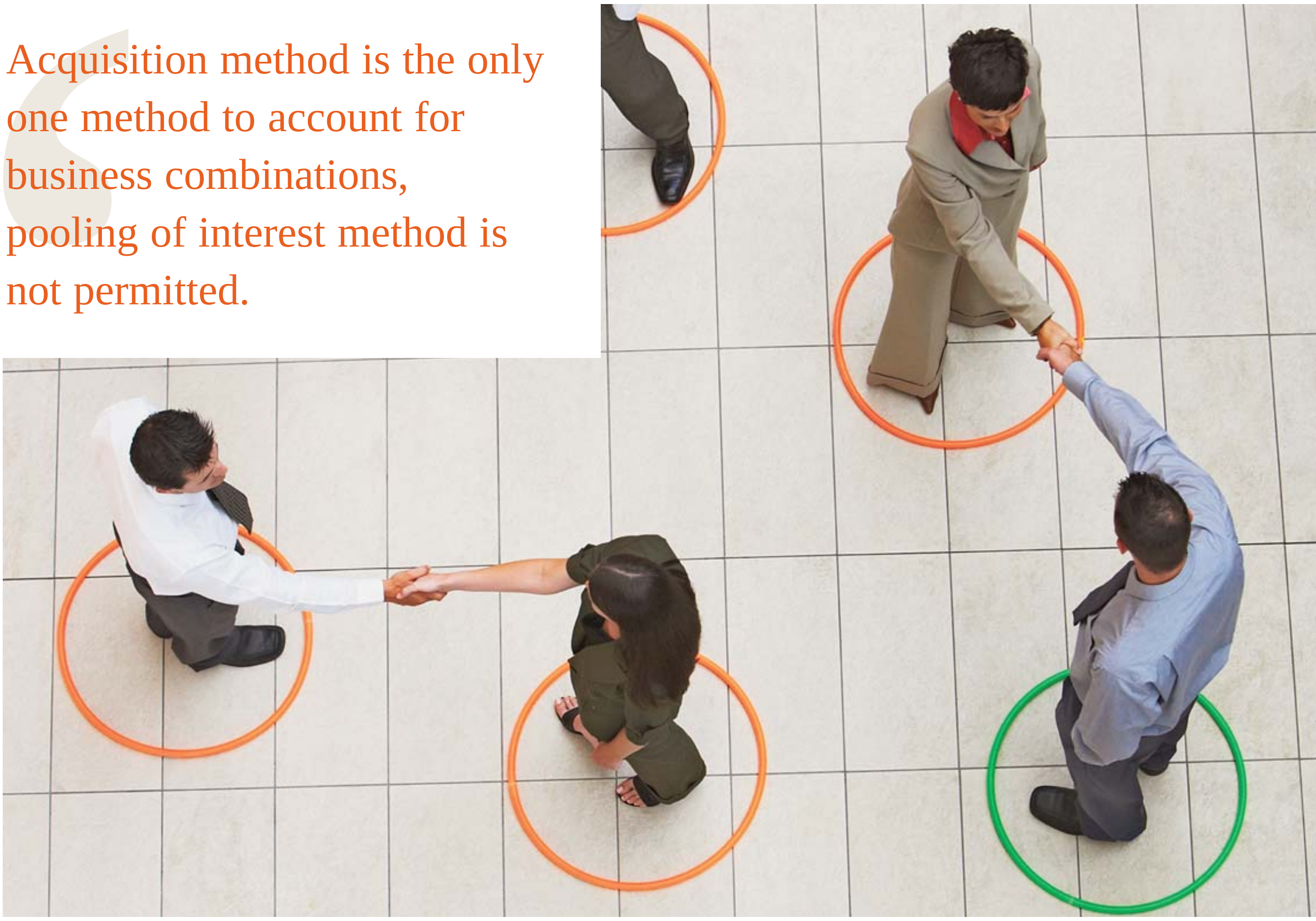
Acquisition of a business in a lump-sum purchase is done on fair value basis.

IFRS 3 does not recognise the pooling of interest method of accounting. All business combinations within its scope are accounted for under the acquisition method on the basis of fair values. Applying the acquisition method requires, 1) identifying the acquirer, 2) determining the acquisition date, 3) recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquire, and 4) recognising and measuring goodwill or a gain from a bargain purchase.

Potential impact

- The pooling of interest method of accounting for business combinations will be prohibited
- Business combinations will consistently follow the fair value basis of accounting
- Structuring of deals with an inclination to issue equity shares in order to satisfy the conditions of pooling of interest accounting will no longer be possible.

> Acquisition method is the only one method to account for business combinations, pooling of interest method is not permitted.



Acquisition date

Under IGAAP, it has been a common practice to consider the date mentioned in the scheme of amalgamation approved by the Courts or the date mentioned in the purchase agreement between the parties, as the acquisition date for all accounting purposes, which in many cases is retrospective and effective from an earlier period.

IFRS 3 defines the date of acquisition as the date on which the acquirer obtains control of the acquiree. This usually will be the closing date, i.e., the date on which the consideration legally is transferred and when the assets are acquired and liabilities are assumed, but this will depend on the facts and circumstances of each case.

Determination of the date of acquisition is important because it is only from that date that the results of an entity are included in the consolidated financial statements of the acquirer. It is also the date on which the fair values of the assets and liabilities acquired are determined and goodwill measured and consideration given up for the acquisition is valued.

Acquisition accounting can not be given effect from a retrospective date based on a court order. Acquisition date is the date on which the acquirer obtains control.

Potential impact

The principle that 'law overrides accounting standards' under IGAAP will not be valid for the determination of the acquisition date. Since IFRS does not recognise this principle of legal override, accounting will need to be done based on the principles enunciated in IFRS 3 and acquisition accounting with retrospective effect based on a High Court order will not be possible.

For example, although a scheme of amalgamation may designate the effective date of acquisition as 1 January 2xx1 and the High Court may approve the scheme as is, if control is transferred to the acquirer on 31 March 2xx1, notwithstanding the High Court approval, the business combination will need to accounted effective 31 March 2xx1.

Consequently, under IFRS 3, the revenue and expenses for the period from 1 January 2xx1 to 31 March 2xx1 would be adjusted against the purchase price, whereas under IGAAP, these would be recognised in the income statement of the acquirer. The dates for measurement of fair values would also vary from 31 March 2xx1 to 1 January 2xx1 for IFRS and IGAAP purposes.

Entities will, therefore, need to ensure that schemes of amalgamation filed for legal approvals follow the principles laid down in accounting standards. In the example above, the scheme of amalgamation would need to designate 31 March 2xx1 as the effective date of the acquisition and this would coincide with the date of transfer of control. The process of obtaining High Court approval would also need to commence sufficiently in advance to ensure that the approval is received before 31 March 2xx1. If the approval is received at a later date, the date of acquisition (which can be a predetermined date) cannot be earlier than the date of that approval (which cannot always be predetermined) since this is a substantive hurdle that must be overcome before control passes.

In the Indian context, the determination of the acquisition date for business combinations may, therefore, present the most significant challenge as corporates may neither have the liberty to determine this date nor control over the timeframe for the completion of acquisitions.

From a broader perspective, will the era of schemes of amalgamation filed with Courts suggesting non-GAAP accounting treatment (such as capitalisation of expenses not otherwise allowed, exemption from amortisation/impairment of goodwill – the list can be long and imaginative) come to an end? To overcome these limitations, would the principle of legal override, contained in the Preface to the Indian Accounting Standards, need to be revisited? These are questions that will need answers before the implementation of the revised standard.

Acquisition-related costs

AS 13, *Accounting for investments* allows acquisition charges such as brokerage, fees and duties to be capitalised as cost of the investment. There is, however, an Expert Advisory Committee (EAC) Opinion which requires that cost related to due diligence incurred to acquire a business should be expensed immediately in the period in which it is incurred. In the absence of any further specific guidance, current practice in IGAAP is to capitalise directly attributable acquisition charges and to expense all other charges. An element of divergence in accounting practice is introduced here due to varied interpretations of which costs are 'directly attributable' and which are not.

Though earlier IFRS allowed costs directly related to acquisitions to be included as part of the purchase consideration and, therefore, within the calculation of goodwill, the revised IFRS 3 (revised 2008) has been amended and requires such costs (e.g., investment banker fee, legal and due diligence fee) be charged to the income statement as incurred. However, cost relating to the issue of debt or equity securities need to be recognised in accordance with IAS 32, *Financial Instruments: Presentation and IAS 39, Financial Instruments: Recognition and Measurement.*

Potential impact

- Entities may need to consider the dimension relating to the impact of acquisition related costs on the income statement. Coupled with variances between estimates and actual expenses incurred, an element of volatility is likely to be introduced in the income statements

- Recognising acquisition - related expenses in the income statement would also improve the quality of assets reflected in the financial statements.

Expensing transaction costs in the income statement is expected to introduce volatile swings in earnings in the periods of large acquisitions.

Contingent consideration

There is limited guidance under IGAAP relating to contingent consideration. The guidance that is available in AS 14 requires that for amalgamations, when additional payment is probable and can be reasonably estimated at the date of the amalgamation, it is included in the calculation of the consideration for the amalgamation. In all other cases, the adjustment for contingent consideration is recognised as soon as the amount is determinable. In practice, goodwill is adjusted on crystallisation of the contingency.

IFRS 3 requires contingent consideration to be estimated at the date of acquisition and recognised at its fair value on that date. The accounting treatment for subsequent adjustment to contingent consideration is based on whether the consideration to be issued is a financial liability or equity. If it is a financial liability, subsequent adjustment is recognised in the profit and loss account and in case the consideration to be issued is an equity instrument, subsequent adjustments are directly adjusted within equity (to be reflected in statement of changes in equity).

Fair valuing contingent consideration is expected to be challenging.

Potential impact

The true value of goodwill relating to acquisitions will be recognised in the first instance and subsequent changes to goodwill resulting from changes to the consideration will be limited. This will probably require that entities use the services of valuation specialists to accurately determine the fair value of contingent consideration on the acquisition date giving due weightage to all the features of such consideration.

Companies will need to be cautious in structuring contingent consideration based on earn-outs which will need to be valued based on probabilities and will require adjustments to the income statement for the difference between estimates and actual compensation. Such adjustments could create income statement volatilities.

Accounting for assets and liabilities taken over, including contingent liabilities

As discussed earlier, IGAAP allows acquisition accounting based on carrying values as well as fair values of the assets and liabilities being acquired. The pooling of interest method requires accounting based on book values with an adjustment of the residual to revenue reserves.

Under IFRS, fair value accounting is a requirement and accounting under the pooling of interest method is prohibited. Further, the process of allocating fair values to assets and liabilities is far more extensive under IFRS as it lays out specific principles to identify intangible assets which meet the definition criterion under IAS 38, *Intangible Assets* but which do not exist on the acquiree's statement of position at the acquisition date. An intangible asset is considered identifiable if it arises from contractual or legal rights or is separable. Common examples of intangible assets identified on business combination are acquired customer relationships, customer lists, in process research and development, trademarks, brands, leases, service contracts, employment contracts, etc.

Interestingly, IFRS 3 also requires contingent liabilities to be recognised at their fair values on the acquisition if there are present obligations arising from past events and their fair values can be measured reliably. The rationale behind recognising contingent liabilities on the acquisition date is that these contingent liabilities would have been factored and discounted while determining the purchase consideration.

Potential impact

- By recognising contingent liabilities, the acquirer brings an 'off-balance sheet' item onto the balance sheet notwithstanding that it may not be probable that an outflow of resources will be required to settle the obligation. Hence, the requirements of IAS 37, *Provisions, Contingent Liabilities and Contingent Assets* (and similar the requirements of AS 29, *Provisions, Contingent Liabilities and Contingent Assets*) do not apply in determining which contingent liability to recognise at the acquisition date
- Determination of the fair values of contingent liabilities, in all likelihood, require the services of valuation experts. It is to be seen whether in practice, standards can be established to determine the fair values of various contingent liabilities reliably to enable such accounting.

> Determining the fair values of contingent liabilities will involve judgment, and require the assistance of valuation specialists.

Minority interest / Non-controlling interest

Under IGAAP, on the date of acquisition, minority interest is valued at its proportionate share of historical book value of net assets.

Once the new standard comes into effect, the term 'minority interest' will be banished to the history books in so far as IGAAP is concerned and will be replaced by the term 'non-controlling interests'.

It is not only a change in the accounting term but also the accounting treatment. IFRS 3 provides an option to the acquirer to measure any non-controlling interests at the point control is obtained at either:

- fair value at the acquisition date, which means that goodwill includes a portion attributable to the non-controlling interest; or
- its proportionate interest in the fair value of the identifiable assets and liabilities of the acquiree, which means that goodwill relates only to the controlling interest acquired.

This election is made on a transaction-by-transaction basis.

In circumstances where the shares are actively traded, this fair value would be measured by reference to market value. Otherwise, a valuation technique would need to be applied.

Potential impact

- In principle, an acquirer should measure all components of a business combination, including any non-controlling interest in an acquiree, at their acquisition-date fair values. However, permitting a choice of accounting methods is likely to reduce comparability of financial statements and is inconsistent with the drive to eliminate accounting alternatives
- Losses applicable to non-controlling interest in a subsidiary are allocated to the non-controlling interest even if this causes the non-controlling interest to be in a deficit position
- An important modification is the inclusion of non-controlling interest as part of shareholders' funds (or total equity). Current practice in IGAAP is to present minority interest outside of shareholders' funds.

Accounting for the residual – need to identify intangible assets

Recognition and measurement

Since business combinations under IGAAP are accounted for on the basis of book values as well as fair values - depending on the nature of the transaction, the resultant residual represents the excess of acquisition cost over the aggregate book/fair value of assets and liabilities acquired, i.e., goodwill. If the acquirer's interest in the net book/fair value of assets and liabilities recognised exceeds the cost of the acquisition, the excess is recognised as a capital reserve. Accounting under the pooling of interest method neither results in goodwill nor capital reserve, but an adjustment to revenue reserves.

Further, contingent liabilities are generally not recognised when accounting for business combinations under IGAAP.

Under IFRS 3, when the sum of the fair value of the consideration transferred, the fair value of any previously held equity interest in the acquiree and the recognised amount of non-controlling interest exceeds the fair value of the identifiable assets acquired and liabilities assumed, the excess is recognised as goodwill. If the goodwill so computed is negative, as a matter of caution, the acquirer needs to reassess the identification and measurement of the acquiree's identifiable assets, liabilities and contingent liabilities and the cost of the business combination. If after reassessment, negative goodwill remains, it is be recognised immediately as a gain in the statement of comprehensive income.

Further, many intangible assets that would previously have been subsumed within goodwill under IGAAP must be separately identified and valued in business combinations accounted under IFRS 3. IFRS provides explicit guidance for the recognition of such intangible assets.

Potential impact

- A common approach will be established for determination of the residual for all kinds of business combinations
- The recognition criterion under IFRS of assets and liabilities will significantly change the value of goodwill recognised. Goodwill will project the actual premium paid by an entity for the acquisition.

> In a business combination, intangible assets need to be identified and allocated prior to reflecting the residual as goodwill.

Reverse acquisitions

Acquisitions under IGAAP are accounted for based on legal form. The legal acquirer and acquiree are treated as such for accounting purposes as well.

It is possible under IFRS 3 that the legal acquirer may be treated as the acquiree and the legal acquiree may be treated as the acquirer for accounting purposes. This is possible because IFRS 3 defines the acquirer as 'the combining entity that obtains control of the combining businesses.' Based on guidance available in IAS 27, *Consolidated and Separate Financial Statements*, one of the criterions to help identify the acquirer is to asses which entity is able to dominate the selection of the management team of the resulting combined entity. In a situation where post acquisition, the management of the legal acquiree takes over control of the acquirer, the legal acquiree will be considered as the acquirer for accounting purposes. The implication is significant as the net assets of the legal acquirer will need to be fair valued and combined with the carrying value of the net assets of the legal acquiree.

For example, S acquires 60 percent of the shares in T. As consideration S issues its own shares to T's shareholders; however, S issues so many shares that T's shareholders obtain an 80 percent interest in S. After analysing all of the elements of control, it is concluded that T is the acquirer for accounting purposes. Therefore, S is the legal parent and accounting subsidiary and T is the legal subsidiary and accounting parent. Accounting for this reverse acquisition will therefore require fair valuation of the assets and liabilities of S rather than T.

Potential impact

The advent of reverse acquisition accounting in IGAAP!

Accounting acquirer would be the legal acquiree and the legal acquirer would be the accounting acquiree in reverse acquisitions.

Other matters for consideration

Provisional accounting

IFRS allow provisional estimation of fair values for recognised assets, liabilities and contingent liabilities as well as the cost of the combination at the date of acquisition. When an entity accounts for a business combination provisionally, the time period for recognition of additional items or adjustment to the fair values assigned to recognised assets, liabilities and contingent liabilities against goodwill is limited to 12 months from the date of acquisition. In order for such an adjustment to be made, the acquirer should demonstrate that the new information provides better evidence of the item's fair value at the date of acquisition. Any adjustments to fair values will have to be treated as prior period adjustments and comparatives will need to be restated.

However, under IGAAP, no change in fair values is permitted after the initial recognising.

Deferred taxation

Deferred taxes arising due to the differences in fair values of the assets and liabilities assumed and their tax bases shall also form part of the purchase price allocation. This is specifically prohibited under the current accounting guidance in IGAAP.

For example, a tax benefit arising from the acquiree's tax losses that was not recognised by the acquiree before the business combination qualifies for recognition as an identifiable asset if it is probable that the acquirer will have future taxable profits against which the unrecognised tax benefit can be applied. The related deferred tax asset will form part of the purchase price allocation and reduce the goodwill recognised.

Step acquisitions

AS 21 provides guidance on step acquisitions which are accounted for on the basis of book values rather than fair values. A majority of business combinations arise in circumstances where the interest goes from 0% to 100% in one go. However, this is not always the case and accounting for 'step acquisitions' has always left preparers reaching for their textbooks. Under IFRS where an entity goes from having an interest in a company (whether investment, associate or joint venture) to a position of obtaining control of that company, it will be required to re-measure to fair value its original investment. This fair value will form part of determining the total consideration given for the acquisition. To the extent that there is a gain or loss on the re-measurement, it will need to be included within the income statement.

However, once control has been obtained, further increases or decreases in ownership interest are treated as transactions with shareholders and recognised in equity. It will not be necessary to re-measure to fair value each time.

'In situations where the acquirer increases his stake from one position of control to the other, any payment in excess of the carrying values of non-controlling interest is recognised as an equity transaction.

Summary

Since its introduction, the term 'fair value' has found little favour with the stakeholders of financial reporting. That is hardly surprising when one considers that there is not much guidance on how to determine that value. Business combinations, in the Indian context, are all set to embrace fair value accounting.

The changes that are likely to be introduced by the IFRS converged business combination are going to affect all stages of the acquisition process – from planning to execution to the presentation of post deal results. The objective being to provide greater transparency and insight into what has been acquired and enabling users of the financial statements to evaluate the nature and financial effects of the acquisition.

What remains to be seen is the extent to which the anticipated accounting standard is able to imbibe the principles of IFRS 3 and to what extent local laws and regulations will create challenges and prevent a full convergence.

> Clearly the adoption of IFRS 3 is expected to have fairly pervasive impacts in the financial statements.

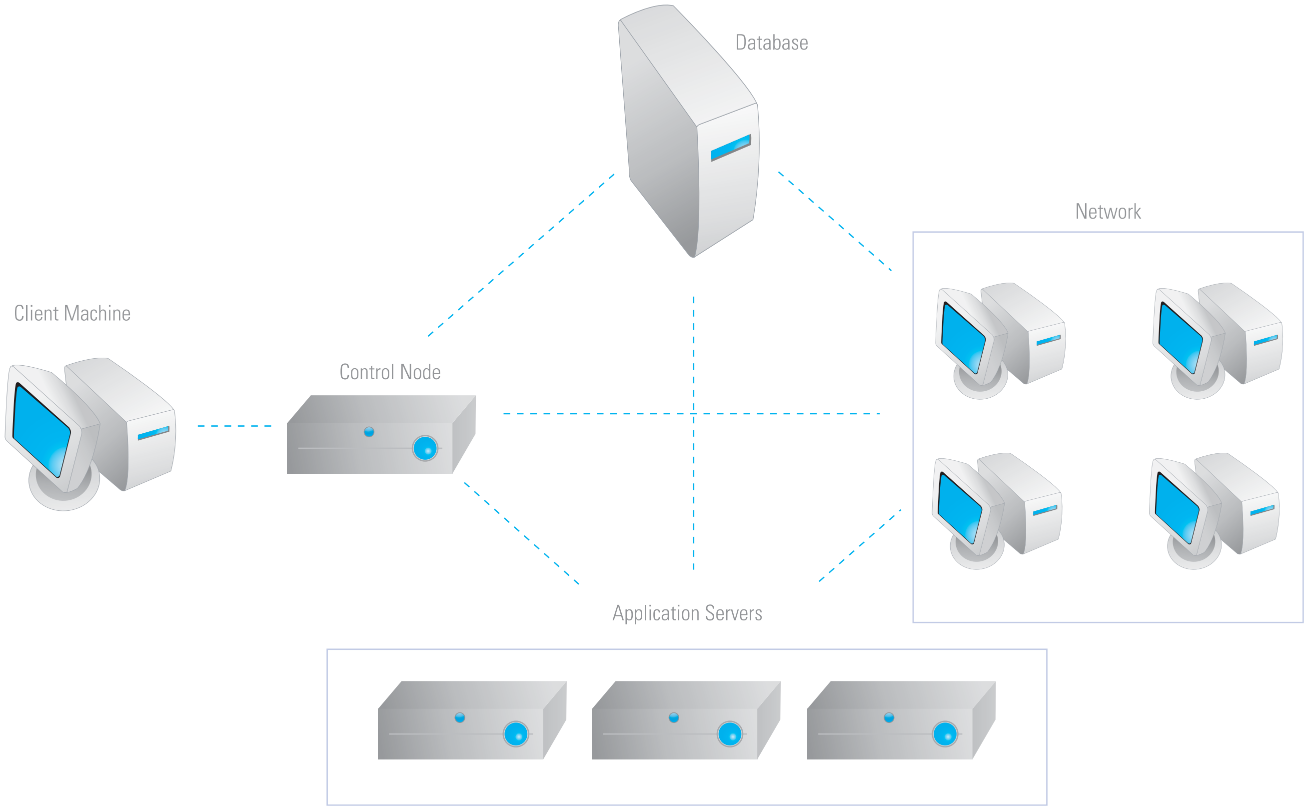
Cloud Computing -
A compelling business model

Cloud computing is an emerging computing technology that facilitates information to be permanently stored on remote servers and accessed via internet based applications using devices like personal computers. Organisations providing cloud computing services (referred as 'Cloud operators') own and maintain common IT infrastructure such as servers, software, operating systems, applications and services which can be used to support the need of multiple customers.

The information is stored in an offshore location which is accessible by a remote user/customer from any device through an internet connection. Customers through this model save capital costs and avoid facing maintenance/upgradation challenges.

Cloud computing provides a means of delivering computing services that makes the underlying technology, beyond the user device, almost invisible. It is a paradigm of computing in which dynamically scalable and often virtualised resources are provided as a service over the Internet. Users need not have knowledge of, expertise in, or control over the technology infrastructure in the "cloud" that supports them.

A pictorial presentation of cloud computing



Cloud computing services generally involve either or a combination of the following:

IT Infrastructure as a service:
Infrastructure vendors provide the physical storage space and processing capabilities that allow for all the services viz. platform and on-demand software services. The products in this segment include ones such as managed hosting and development environments that allow users to build applications. Major cloud operators include IBM, Google and Amazon.com[1].

Platform as a service: Platform-as-a-service in the cloud is defined as a set of software and product development tools hosted on the provider's infrastructure. Developers create applications on the provider's platform over the Internet. Example:- Salesforce.com's platformforce.com allows subscribers to access their applications over the internet. Google, Netsuite and Microsoft[2] have also developed platforms that allow users to access applications from centralised servers.

Software as a service: In the past, the end-user would generally purchase a license from the software provider and then install and run the software directly from on-premise servers. Using an On-Demand service however, the end-user pays the software provider a subscription fee for the service. The software is hosted directly from the software providers' servers and is accessed by the end user over the internet. For example, web-based e-mail offered by Google[3].

> Cloud computing is essentially a *Capex* versus *Opex* debate.

1. Website of IBM, Google and Amazon
2. Website of Google, Netsuite and Microsoft
3. Website of Google

Key benefits?

Under cloud computing, pricing models used include fixed monthly/quarterly subscription payments, or billings based on variable usage, or a combination of both. In either of the scenarios, these models are beneficial to new setups and smaller companies who can not afford the significant upfront cost of owning, maintaining and managing an appropriate IT infrastructure. Even for larger organisations, cloud computing is emerging as a compelling proposition. The general benefits include:

- Organisations can concentrate on their core competencies
- Initial IT setup costs will no longer be a barrier for start up companies
- The effective utilisation of common infrastructure costs of Cloud operators brings down the overall fixed and variable costs of customers
- Services, particularly for start-ups in a growth phase can be quickly expanded or contracted without major overhauls to the IT infrastructure
- Upgradation to newer technologies occur at affordable costs as the financial impact of obsolescence is minimised from the customer's perspective.

Are there any challenges?

Some of the challenges associated with cloud computing are summarised below:.

Security - By utilising cloud computing, a customer will be storing their sensitive data outside their servers with an external provider.

Not Platform Independent - Most clouds force participants to rely on a single platform or host only one type of product.

Speed - Putting data in the cloud means accepting the latency inherent in transmitting data across the country and the wait as corporate users tap the cloud and wait for a response.

Reliability - There have been instances where the services offered by providers have experienced outages.

Cloud computing in India

The Indian market for cloud computing is huge. The Indian companies are expected to move to cloud operators rather than setting up their own IT infrastructure. Further, global cloud operators like IBM and Google are providing cloud computing services in India[1].

Key accounting considerations

United States Generally Accepted Accounting Principles (US GAAP) provides detailed guidance on addressing the accounting challenges faced by the Cloud operators. However, under Indian accounting framework and International Financial Reporting Standards (IFRS), there is limited direct literature on point.

We have analysed the accounting challenges from an IFRS perspective as India is inching towards IFRS. We have also brought out the key differences between IFRS, US GAAP and IGAAP in dealing with these matters.

Cloud operators incur significant start-up costs. Further, revenues are generated over a long period. The key accounting issues include: (1) revenue recognition; and (2) accounting for start-up and maintenance costs.

Revenue recognition

Generally, cloud computing offerings tend to have multiple elements such as data migration, training, data storage, computing tools, operating platform and software. These services are generally rendered to customers either at different points of time over the contract period or throughout the contract term. The key steps to be followed would include: (1) Identifying the elements of the arrangement; (2) Allocating consideration to the individual elements; and (3) determining the manner and timing of revenue recognition for each element.

The effective utilisation of common infrastructure costs brings down the overall fixed and variable costs of customers.

Identifying the elements of the arrangement

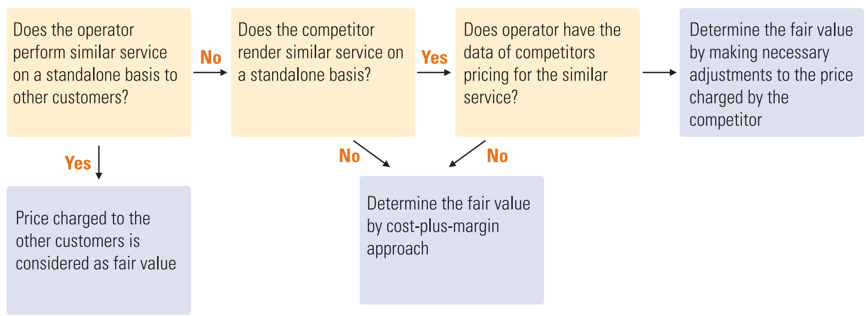
Judgement is required when analysing arrangements to determine whether more than one component exists. Components generally include all performance obligations imposed on a vendor by a customer agreement. Cloud operators provide multiple services like data migration, customisation of the platform, training, hosting, support etc. Further, not all of these components of the arrangement are delivered to the customers upfront. Accordingly, there would be an accounting challenge to allocate revenues between delivered elements and undelivered elements. International Accounting Standard (IAS) 18, *Revenue* does not provide detailed guidance on separation of each of the components within an arrangement. Analogies may be drawn from International Financial Reporting Interpretations Committee (IFRIC) 18, *Transfer of Assets from Customers* to conclude that the key feature of a separately identifiable service or element is the existence of: (1) stand-alone value to the customer; and (2) the fair value of the component can be measured reliably.

How do you assess whether an element has stand-alone value to the customer?

The term "stand-alone value" is used in IFRIC 18 but is not defined in IFRS nor does IFRIC 18 contain any discussion of how to determine if a component of an arrangement has "stand-alone value". Some argue that in situation where an item is not sold separately or cannot be resold, there is no stand alone value for that item. This view is consistent with the determination of whether an item has value on a stand-alone basis in US GAAP literature. Under US GAAP, a delivered element has stand-alone value if a vendor sells the item on a stand-alone basis or the customer could resell it for other than scrap or salvage value. Others have read stand-alone value to have a broader meaning than as defined under US GAAP and believe that an item has stand-alone value if the customer derives value from that item that is not dependent on receiving other deliverables under the same arrangement. In our view, both of these interpretations of stand-alone value are acceptable. We believe that an entity should make an accounting policy choice and disclose and apply that accounting policy consistently in determining the definition of stand-alone value. Regardless, of the policy applied, the determination of whether a component within an arrangement has stand-alone value to the customer depends upon facts and circumstances and requires judgement.

How to determine the fair value?

Steps to determine the fair value are detailed below –



Fair value of the separately identifiable component of an arrangement is determined based on the price charged by the Cloud operator to another customer when an identical product or service is sold on a standalone basis. Another alternative method would be to consider the price of a similar product or service sold by a competitor after making necessary adjustment for differences between the products or services.

> Determining the manner of separation of the individual elements such as platform customisation, hosting, support etc. could be challenging.

In case where the Cloud operator is not able to acquire the market data of the price charged by the competitor, a cost-plus-margin approach to determine the fair value of a component should be applied. This method can be used if the Cloud operator is not able to determine the fair value based on the other approaches mentioned earlier. Also, there will be challenges to identify and determine "What should be included in cost" and to arrive at a "profit margin". Cloud operators may need to deploy systems to accumulate the costs including the appropriate tracking systems.

Allocation of consideration to the individual components

IAS 18 does not provide guidance on the allocation of revenue to individual components. However, recent interpretations such as IFRIC 13 *Customer Loyalty Programmes* and IFRIC 15 *Agreements for the Construction of Real Estate* in respect of real estate sales have specific guidance on allocation of revenues and these interpretations by analogy can be applied by the Cloud operators.

The interpretations noted above require allocation of revenues between the components using either of the relative fair value method or the residual method.

Under relative fair value method, the total consideration is allocated to the different components based on the ratio of the fair values of each component.

Under residual method, the undelivered components are measured at fair value, and the remainder of the consideration is allocated to the delivered component.

Applying the residual method in a cloud computing services arrangement may not be straight forward as there may not be any delivered component at the inception since most of the components of the arrangement are services which will be delivered over the term of the arrangement.

Determining the timing of revenue recognition for each component

Timing of recognition of revenues is based on various conditions that are required to be met in order to recognise revenues. In cloud computing services, the crucial requirement is for the Cloud Operator to identify the timing of rendering of services. Also, the services provided by the Cloud Operator are continuous in nature and accordingly, determination of the point at which the Cloud Operator can commence recognition of revenue and determination of time period over which the revenue is required to be recognised for each component is critical.

The cloud computing services are generally provided under a long term contract. Therefore, revenue recognition from each component begins once the initial configuration is completed and delivery of the cloud computing services commences if other revenue recognition criteria have been met. As services provided are in the nature of indeterminate number of acts over the contract period, without any one act being more significant than the others, straight-line basis of recognition of revenues over the contract period seems to be appropriate.

Revenues from other services like data migration, customisation of the platform, training, etc will be recognised separately when the related services are performed and should not be included in arriving at the revenues based on straight line method.

The limited explicit guidance on revenue recognition under IFRS is expected to make the accounting challenging for cloud operators.

Key GAAP differences specific to recognition of revenues from cloud computing services

Key areas	IFRS	USGAAP	Indian GAAP
Identifying components of the arrangement	There is no detailed guidance. Analogy from IFRIC 18 could be drawn by the cloud operators under which the components are separated if • the component has stand-alone value to the customer; and • the fair value can be measured reliably.	EITF 00-21 "Revenue arrangement with multiple deliverables" requires a Cloud Operator to separate the components if the following are met: • The delivered item(s) has value to the customer on a stand-alone basis • There is objective and reliable evidence of the fair value of the undelivered item(s) • If the arrangement includes a general right of return relative to the delivered item, delivery or performance of the undelivered item(s) is considered probable and substantially in the control of the operator. The application of these specific criteria is likely to give rise to differences from IFRS in practice. Additionally, because all criteria are required to be met under US GAAP, there may be arrangements with separate units of accounting under IFRS that do not qualify for separation under US GAAP.	In the absence of guidance to separate multiple elements in an arrangement, revenues with respect to each of the individual elements may be recognised as service transactions either by the application of the proportionate completion method or by the completed service contract method.
Allocating consideration to the individual components	There is no specific guidance. Analogy from IFRIC 13 would indicate the application of either relative fair value method or the application of the residual method.	Unlike IFRS, there is detailed guidance on allocation of consideration to the individual components. If the fair value is available for all the components, the revenue should be allocated to each component based on the relative fair value method. If fair value is not available for all the components, the operator, after establishing the fair values for all of the undelivered elements apply a residual method to derive the revenues for the delivered elements after deferring the fair value of the undelivered element(s).	There is no specific guidance under Indian GAAP. Practices could vary depending upon the accounting policy choices adopted by companies.
Determining the timing of revenue recognition for each component	Revenue recognition from each component begins once the initial configuration is completed and delivery of the cloud computing services commences. Revenue can be recognised on straight-line basis over the contract period.	Like IFRS, revenue recognition from each component begins once the initial configuration is completed and delivery of the cloud computing services commences. SAB 104 also indicates straight-line basis of revenue recognition over the contract period as most appropriate method of revenue recognition for similar services.	Under Indian GAAP, the revenue recognition is likely to be consistent with the guidance available under IFRS.

Accounting for the costs incurred to render cloud computing services

Cloud operators are expected to incur the following types of costs:

- Website development costs
- Costs to setup infrastructure like servers to maintain customer accounts and protect customer data
- Costs to set up and deliver the solution and
- Costs to maintain the website, delivery engine or other customer interface.

Website development costs

The website developed by the Cloud Operators to provide services and also for internal access is an internally-generated intangible asset. The recognition of this internally generated intangible asset in the financial statements of the Cloud operator is subject to the fulfillment of the conditions laid down in IAS 38, *Intangible Assets* and SIC 32 *Intangible Assets – Web Site Costs*. In accordance with IAS 38, an intangible asset shall be recognised only if it is probable that the expected future economic benefits attributable to the asset will flow to the entity and the cost of the asset can be measured reliably.

The website used by the Cloud Operator to provide cloud computing services can either be an existing corporate website or internally developed specifically to provide the cloud computing services. The internally developed website to provide cloud computing services is expected to meet the definition of an intangible asset and also the recognition criteria of an intangible asset. Accordingly, directly attributable costs, for example labour and materials incurred during the development phase, are capitalised from the date that the Cloud operator is able to demonstrate:

- the technical feasibility of completing the website so that it will be available for use
- its intention to complete the website and use it
- its ability to use the website
- how the website will generate probable future economic benefits
- the availability of adequate technical, financial and other resources to complete the development and to use the website; and
- its ability to measure reliably the expenditure attributable to the website during its development.

It is important to evaluate the stage of the website development in which the costs are incurred. If such expenses are incurred post the point of time at which the Cloud operator can demonstrate the matters listed above, the costs should be capitalised as an asset. Any costs incurred prior to the fulfillment of the aforementioned conditions should be expensed as incurred.

Further, SIC-32 provides guidance on evaluating costs incurred during the various stages of developing a website and requires Cloud Operators to capitalise costs incurred during the development phase (i.e., expenditure incurred during the application and infrastructure development stage, the graphical design stage and the content development stage) that are directly attributable to preparing the website to operate in the manner intended by the management and that meet the criteria for the recognition of an intangible asset. All other costs are expensed as incurred.

Considering that the website is used by the Cloud Operator to generate revenue through cloud computing services, a majority of the costs incurred may qualify for capitalisation under IFRS.

Key GAAP differences specific to recognition of website development costs

IFRS	USGAAP	Indian GAAP
Costs associated with Web sites developed for advertising or promotional purposes are expensed as incurred. For other Web sites, expenditure incurred during the application and infrastructure development stage, the graphical design stage and the content development stage are capitalised if the criteria for capitalising development costs are met. The costs of developing content for advertising or promotional purposes are expensed as incurred.	Web site development costs are subject to general capitalisation criteria applicable to internal-use software which differs from IFRS. Unlike IFRS, there are special requirements for the development of internal-use software. Costs incurred for internal-use software are capitalised depending on the stage of development. The stages of software development are the preliminary project stage, application development stage and post-implementation stage. Costs incurred during the preliminary project stage and the post-implementation stage are expensed as incurred. Costs incurred in the application development stage that are capitalised include only: • external direct costs of materials and services consumed in developing internal-use software; and • payroll and payroll-related costs for employees who are directly associated with and who devote time to the internal-use software project. General administrative and overhead costs are expensed as incurred. The application development stage, which is necessary to commence capitalising costs under U.S. GAAP, often will occur sooner than the date that the criteria for capitalising development costs under IFRSs are met. Therefore both the timing of commencing capitalisation and the amounts capitalised are likely to be different from IFRSs.	The accounting treatment for website development costs are in line with IFRS.

Costs to setup infrastructure like servers to maintain customer accounts and protect customer data

Costs incurred to acquire equipment or other infrastructure (e.g., servers and storage devices) are subject to the requirements of IAS 16, *Property, Plant and Equipment* and generally would be capitalised. The accounting treatment under US GAAP and IGAAP are similar to IFRS.

Costs to set up and deliver the solution, and to maintain the website, delivery engine or other customer interface

Costs to set up and deliver the solution and to maintain the website, delivery engine or other customer interface would be expensed as incurred unless they are costs to acquire and install property, plant and equipment (e.g., servers and other hardware). The accounting treatment under US GAAP and IGAAP are similar to IFRS.

Summary

While the concept of cloud computing is thought provoking and indicates the direction in which IT services industry will leap forward, the accounting considerations indicate that significant judgment would be required to recognise revenues for the multiple element arrangements and capitalise and amortise development costs.

Regulatory Updates

Amendments to the Equity Listing Agreement

On 5 April 2010, the Securities and Exchange Board of India (SEBI) has decided to incorporate certain specific listing conditions thereby amending the Equity Listing Agreement (ELA) in order to bring more transparency and efficiency in the governance of listed entities.[1]

The key amendments to the ELA are as follows:

1) Voluntary adoption of International Financial Reporting Standards (IFRS) by listed entities having subsidiaries

With increasing globalisation witnessed in the Indian economy and particularly in the corporate sector, there was a need for harmonising the financial reporting standards for Indian companies with International Financial Reporting Standards (IFRS) in order to enable global comparison of financial results across industries and sectors. Pursuant to this need, the Ministry of Corporate Affairs (MCA) of India made a landmark announcement of defined roadmap for achieving convergence of Indian accounting standards with IFRS.

In order to enable entities to familiarise with the requirement of IFRS, the SEBI has amended the clause 41 of ELA to provide listed entities having subsidiaries with an option to submit consolidated financial results either in accordance with the accounting standards specified in Section 211(3C) of the Companies Act, 1956 (the Act) or in accordance with IFRS issued by the International Accounting Standard Board (IASB).

In case of entities that will exercise this option, the current period figures will be as per IFRS and the comparative figures would be as per notified Accounting standards, a reconciliation is required to be provided for significant difference between figures disclosed as per IFRS and figures that would have been if notified Accounting Standards were adopted.

Submission of standalone financial results to the stock exchanges shall continue to be in accordance with Indian GAAP.

The amendment is applicable in respect of annual audited results for the year ended 31 March 2010 and quarterly results for the quarter ended on 31 March 2010.

1. SEBI vide its circular CIR/CFD/DIL/1/2010 dated 5 April 2010 has introduced amendmendts to the equity listing aggrement.

The current amendment to the ELA has resulted in certain unanswered questions that need to be clarified / considered while exercising this option and is summarised below:

- Clause 32 of the ELA mandates companies to publish audited Consolidated Financial Statements in the Annual Report in addition to the individual financial statements. This clause is silent on the GAAP that needs to be followed by the Companies while preparing these Consolidated Financial Statements. The recent circular issued by the SEBI does not make any reference to the Clause 32 while amending the requirements of the Clause 41. This can lead to diversity in views. Few companies may interpret in a manner that this alternative is only available for earnings release and not for the purpose of annual accounts which will require publishing of consolidated financial statements as per Indian GAAP only. This interpretation will be on the premise that for the purpose of incremental disclosures required in the annual accounts as per the clause 32 the definitions of parent, subsidiary and related parties have been derived from the Indian Accounting Standards. We believe that a clarification from the SEBI will put the issue beyond doubt as continuing to publish consolidated financial statements as per Indian GAAP for the purpose of clause 32 will increase the burden on the company in terms of time and cost and will also create seemingly unnecessary confusion. Pending such clarification, it will be advisable that reconciliation should be given in respect to the significant differences between the figures disclosed as per IFRS and the figures as they would have been if the consolidated financial statements were prepared as per Indian GAAP

- Section 212 of the Act, 1956 requires the auditors' report, directors' report and financial statements of the subsidiaries to be attached along with the financial statements of the holding company. These financial statements of the subsidiaries are required to be prepared in accordance with Section 211(3C) of the Act. The Ministry of Corporate Affairs (MCA), on application may provide conditional exemption from the requirement of Section 212. One of the conditions is that the consolidated financial statements should be prepared in strict compliance with accounting standards and ELA. This can lead to diversity in views. Few companies may interpret that the term "accounting standards" is as defined in the Act, which is the Indian Accounting Standards. Accordingly, if consolidated financial statements as per IFRS are published the exemption under section 212 of the Act may not be available. This can be a significant disincentive to prepare consolidated financial statements under IFRS

- As per the defined roadmap for convergence of Indian Accounting Standards with IFRS announced by the MCA, the companies qualifying in Phase 1 will prepare its first set of consolidated financial statements on 1 April 2011. From the quarter June 2011 onwards the listed companies (Phase 1) will have the alternative to prepare consolidated financial statements as per converged accounting standards or as per IFRS issued by the IASB. Currently, section 211(3C) of the Act does not mandate consolidated financial statements which can likely happen when converged accounting standards become part of this section. An anomaly is likely to arise on whether the Companies can take the benefit of this alternative of publishing consolidated financial statements as per IFRS as issued by the IASB as they will have to mandatorily present consolidated financial statements in accordance with the converged accounting standards to be in compliance with Section 211(3C) of the Act. The practice will emerge in this area.

2) Timelines for submission and publication of financial results by listed entities

IAs per the requirements of the existing ELA, listed entities had the following options:

- Submit either audited or un-audited quarterly and year to date financial results within one month from the end of each quarter (other than the last quarter). In case an un-audited financial result is submitted, a limited review report by the auditors must be submitted within two months from the end of the quarter

- In case of last quarter, the entity can submit the un-audited results for the quarter within one month from the end of the quarter and a limited review report within two months from the end of the quarter. However, in case the entity opts to submit an audited financial result for the year, then the same needs to be submitted within three months from the end of the financial year

- Entities also have an option to submit standalone quarterly financial results or consolidated quarterly financial results to the stock exchange. In the case of annual audited financial results, the entity is required to submit a standalone and consolidated financial results to the stock exchange.

  In order to streamline and reduce the timeline for submission of financial results to the stock exchange by listed entities, the SEBI amended the ELA and the revised timelines are stated below:

- Quarterly financial results (audited or un-audited with limited review), standalone or consolidated, must be disclosed within 45 days of the end of the quarter

- Annual financial results on standalone and consolidated basis must be disclosed within 60 days from the year end in case the entity has opted to submit annual audited results in lieu of last quarter un-audited results with limited review

- In case the entity publishes only consolidated financial results then (a) turnover (b) PBT and (c) PAT on a standalone basis must also be published.

The amendment is applicable in respect of annual audited results for the year ended 31 March 2010 and quarterly results for the quarter ended on 31 March 2010.

We believe that this amendment will create significant pressure on the financial reporting system of various companies who were taking the full benefit of the timelines allowed earlier.

3) Requirement of auditors' certificate for accounting treatment under scheme of arrangement

The scheme of amalgamation / merger / reconstruction etc of certain listed entities submitted to the Honorable High Court for approval, included the proposed accounting treatment that will be adopted in case of amalgamation / merger / reconstruction etc. The SEBI observed that these proposed accounting treatments were not in accordance with the accounting standards specified under Section 211(3C) of the Companies Act, 1956. As a result of this, the financial statements of the entity were not in compliance with the accounting standards.

In order to ensure compliance with the accounting standards, the SEBI amended the ELA, thereby requiring auditors' certificate for compliance of all applicable accounting standards in relation to accounting treatment for the scheme of amalgamation / merger / reconstruction etc to be submitted to the concerned stock exchange under clause 24(f) of ELA.

The amendment is applicable to all schemes of amalgamation / merger / reconstruction etc. of the listed entities that are being filed before the Honorable Courts / Tribunals on or after the date of the circular.

The other amendments to ELA are as follows:

1. *Requirement of a valid peer review certificate for statutory auditors*

   For all listed entities, the auditors appointed must have been subject to the peer review process and should hold a valid certificate issued by the 'Peer Review Board'.

   The amendment is applicable for all financial statements submitted to stock exchanges after appointment of auditors for accounting period commencing on or after 1 April 2010.

2. *Interim disclosure of Balance Sheet items by listed entities*

   The asset-liability position of the entities must be disclosed within 45 days from the end of the half-year as a note to the half-yearly financial results. The amendment is applicable with immediate effect.

3. *Modification in formats of limited review report and statutory auditors' report*

   The formats have been amended to make it clear that disclosures pertaining to details of public shareholding and promoters' shareholding, including details of pledged/encumbered shares of promoters/promoter group, contained in the format are traced from disclosures made by the management. The amendment is applicable with immediate effect.

4. *Approval of appointment of CFO by the Audit Committee*

   The appointment of the CFO must be approved by the Audit Committee before finalisation by the management. The amendment is applicable with immediate effect.

The above circular can be accessed through the below mentioned link http://www.sebi.gov.in/Index.jsp?contentDisp=Section&sec_id=1

Convergence with IFRS – MCA approves roadmap for insurance companies, banking companies and NBFCs

On 22 January 2010, the Ministry of Corporate Affairs (MCA) of India made a landmark announcement defining the roadmap for achieving convergence of Indian accounting standards with International Financial Reporting Standards (IFRS) vide press release. However, the roadmap for convergence agreed was in respect of companies other than insurance, banking and non-banking finance companies.

On 31 March 2010, the MCA approved the roadmap in respect of insurance, banking and non-banking financial companies (NBFCs) vide press release. The recommendations for each class of companies are as follows:

Companies	Compliance with converged Indian Accounting Standards
All insurance companies	1 April 2012
Banking companies	
• All scheduled commercial banks	1 April 2013
• Urban co-operative banks with net worth in excess of Rs 300 crores	1 April 2013
• Urban co-operative banks with net worth in excess of Rs 200 crores but not exceeding Rs 300 crores	1 April 2014
• Urban co-operative banks with net worth in not exceeding Rs 200 crores and Regional rural banks	Apply existing notified Indian accounting standards. However, voluntary adoption is permitted
Non-banking financial companies	
• NBFCs which are part of Nifty 50 or Sensex 30	1 April 2013
• NBFCs whether listed or not with net worth in excess of Rs 1,000 crores	1 April 2013
• All listed NBFCs and those unlisted NBFCs with net worth in excess of Rs 500 crores but not exceeding Rs 1,000 crores	1 April 2014
• Unlisted NBFCs with net worth not exceeding Rs 500 crores	Apply existing notified Indian accounting standards. However, voluntary adoption is permitted.

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