ACCOUNTING AND AUDITING UPDATE

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Editorial
Amendments to the Companies Act, 2013 (2013 Act) have received assent from the Indian President on 25 May 2015. Key amendments like fraud reporting, shareholders’ approval for related party transactions and prohibition of public inspection of board resolutions filed with the Registrar of Companies are substantive. In this edition of the Accounting and Auditing Update, we provide an overview of the key amendments to the 2013 Act and corresponding amendments made in the Rules thereon.

Companies face a number of challenges when they derecognise a financial asset or a liability from their balance sheets. We have analysed the key principles governing derecognition of a financial instrument as envisaged in the IAS 39, *Financial Instruments: Recognition and Measurement.*

Recently, the Expert Advisory Opinion (EAC) of the Institute of Chartered Accountants of India (ICAI) issued two important opinions – one clarifying the principles of AS 25, *Interim Financial Reporting* and its application on interim financial statements and second on the accounting treatment of liquidated damages under a contract. In this edition, we discuss the requirements of AS 25, challenges that the companies may face in estimating the income tax expense for the interim periods. Also, we have highlighted important points of the EAC on accounting of liquidated damages under a contract and the corresponding guidance under Ind AS 115, *Revenue from Contracts with Customers.*

In addition to the above, we have also analysed the key impact on Ind AS implementation and status of the IASB-FASB convergence project on lease accounting, i.e. AS 17, *Leases.*

This edition also carries an overview of the guidance notes released by the ICAI in May 2015 on Accounting for Derivative Contracts and Accounting for Expenditure on Corporate Social Responsibility (CSR) activities.

Apart from our regular round up of regulatory updates, this edition also provides an update on the International Accounting Standards Board’s (IASB) potential decision to defer the effective date of IFRS 15, *Revenue from Contracts with Customers,* and a summary of a recent amendment to U.S. GAAP standard on consolidation.

As always, we would like to remind you that in case you have any suggestions or inputs on topics we cover, we would be delighted to hear from you.
Derecognition of a financial instrument

This article aims to:

- Focus on the principles/application of IAS 39, Financial Instruments: Recognition and Measurement with respect to derecognition of a financial instrument.

Background

‘Derecognition’ in the context of a financial instrument can simply be understood as the removal of a previously recognised financial asset or financial liability from an entity’s statement of financial position. It is often not very difficult to assess whether a financial instrument should be derecognised. For example, an entity holds an investment (financial asset), on maturity of the investment all cash flows pertaining to the principal and interest are received, thereafter, there are no longer any rights to receive cash from such investment and therefore the entity derecognises the asset. Alternately, if the entity sold this investment for a consideration, post such sale the entity is no longer susceptible to the risks (e.g. changes in value) or rewards (e.g. cash flows by way of interest or appreciation in value) from such investment, accordingly the entity derecognises the asset.

In the real world, however, transactions may not necessarily be as simplified as in the above examples. Entities may design or structure complex transactions to achieve one or multiple objectives e.g. a bank securitises part of its mortgage portfolio to reduce its risk weighted exposure and manage capital more efficiently. Such structured transactions usually have many conditions embedded within them which make the assessment of derecognition difficult.

IAS 39, Financial Instruments: Recognition and Measurement (also referred to as ‘the standard’) among other things, establishes the principles for recognition and derecognition of financial instruments. IAS 39 contains a set of requirements that should be applied while assessing derecognition of all financial instruments including more complex securitisation transactions.

Despite the standard being applicable and in practice for many years, users often face challenges in applying the requirement on more complex structured transactions, in particular, the assessment of ‘continuing involvement’ which can at times be challenging to apply in practice.

Derecognition of a financial asset

Before evaluating whether, and to what extent, derecognition is appropriate, an entity needs to determine whether derecognition principles should be applied to a part of a financial asset (or a part of a group of similar financial assets) or a financial asset (or a group of similar financial assets) in its entirety.

Once the entity has determined at what level (e.g. standalone entity or consolidated) it is applying the derecognition principles and to which identified asset (e.g. individual, group or component) those requirements should apply, it can start assessing whether derecognition of the asset is appropriate. For the purpose of assessing whether or not a financial asset needs to be derecognised, IAS 39 purports two main principles:

- transfer of risks and rewards approach, and
- transfer of control approach.

Derecognition requirements for financial assets came under heightened scrutiny on the back of the 2007 global credit crisis whereby stakeholders challenged the accounting for a plethora of structured transactions which were designed to achieve derecognition in an entity’s statement of financial position.

Key notes - recent developments

On 16 February 2015, the Ministry of Corporate Affairs notified 1 April 2016 to be the effective date for all phase 1 companies to comply with the Indian Accounting Standards (Ind AS). Ind AS 109, Financial Instruments, which is modelled on IAS 39, incorporates similar principles for evaluating derecognition of financial instruments.
IAS 39 provides a flowchart which summarises derecognition requirements and conditions. Every transaction being assessed for derecognition should be analysed using the strict sequence set out in the flowchart.

Source: Extract of IAS 39

Consolidate all subsidiaries (including any SPE) [Paragraph 15 of IAS 39]

Determine whether the derecognition principles below are applied to a part or all of an asset (or group of similar assets) [Paragraph 16 of IAS 39]

- Have the rights to the cash flows from the asset expired? [Paragraph 17(a) of IAS 39]
  - Yes → Derecognise the asset
  - No

- Has the entity transferred its rights to receive the cash flows from the asset? [Paragraph 18(a) of IAS 39]
  - Yes
  - No → Continue to recognise the asset

- Has the entity assumed an obligation to pay the cash flows from the asset that meets the conditions in paragraph 19? [Paragraph 18(b) of IAS 39]
  - Yes → Derecognise the asset
  - No

- Has the entity transferred substantially all risks and rewards? [Paragraph 20(a) of IAS 39]
  - Yes → Derecognise the asset
  - No

- Has the entity retained substantially all risks and rewards? [Paragraph 20(b) of IAS 39]
  - Yes → Continue to recognise the asset
  - No

- Has the entity retained control of the assets? [Paragraph 20(c) of IAS 39]
  - Yes
  - No → Derecognise the asset

Continue to recognise the asset to the extent of the entity’s continuing involvement
In the following paragraphs, we provide further insights on the aforementioned two approaches. We shall first try to decipher the concept of ‘transfer’ in the context of assessing derecognition.

**Transfer**

As per the requirements of IAS 39, a financial asset is derecognised by an entity when: (a) the contractual rights to the cash flows from the financial asset expire, or (b) it transfers the financial asset and the transfer qualifies for derecognition under IAS 39.

The standard further sets out the following conditions for assessing ‘transfer of a financial asset’. An entity transfers a financial asset if, and only if, it either:

- transfers the contractual rights to receive the cash flows of the financial asset (e.g. by way of a legal sale or assignment), or
- retains the contractual rights to receive the cash flows of the financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients (often referred to as a ‘pass-through arrangement’).

**Asset servicing/administration rights**

Sometimes transactions may be structured in a manner whereby following the transfer of contractual rights to receive cash flows from an asset, the transferor may continue to administer or provide servicing on such asset.

For example, the transferor may continue to collect cash flows on behalf of the transferee only in the capacity of an agent rather than for its own benefit. For the purpose of evaluating derecognition, the retention of servicing rights on an asset by the transferor should not by itself render the transfer to fail, rather the existence of such terms and conditions needs to be considered holistically with any other conditions to conclude whether in spirit there has been a transfer of all risks and rewards by the transferor.

**Pass through arrangements**

A key difference between pass through arrangements and asset servicing rights is that in the case of the former, the transferor has retained the contractual rights to cash flow whereas in case of the latter there has been a transfer of contractual rights.

Pass through arrangements come into play when the transferor has retained the contractual rights to receive cash flow on an asset and also assumed a contractual obligation to pay those cash flows to one or more parties (‘eventual recipients’).

For example, an SPE may issue beneficial interests in an underlying financial asset to investors but continue to own those financial assets.

The standard sets out the conditions that need to be met for a pass through arrangement to qualify as a transfer of financial asset and thereby be derecognised in the books and records. Essentially these conditions require that the:

- transferor is not obliged to transfer cash flows to the eventual recipients unless it has collected them from the transferred asset
- transferor cannot sell/pledge the asset other than as security to the eventual recipients for the obligation to pay them cash flows
- transferor needs to remit cash flows to the eventual recipients ‘without material delay’ and transferor cannot reinvest such cash flows except for by way of investments in cash and cash equivalents and interest earned on such investments is passed to the eventual recipients.

If all the three conditions for pass through arrangements are met, then similar to the analogy drawn in the case of asset servicing rights, the transferor may represent more as an agent of the eventual recipient than being the owner of the asset. Thereby, in principle, such arrangements would be treated as a transfer of contractual rights to the cash flows and would be considered for derecognition.

Entities commonly use securitisations to monetise financial assets, such as homogeneous consumer loans, credit card receivables, trade receivables or mortgage loans, by selling newly created securities collateralised by these financial assets to investors. Such securitisation transactions are often executed using structured entities that have limited activities. The purpose of the structured entities is to hold the interests in the securitised financial assets and to pass through cash flows earned on these financial assets to the investors in the notes issued by the structured entities.

In a typical securitisation, the transferring entity assigns financial assets to the structured entity in return for cash proceeds. The transfer of financial assets, issue of notes to investors and payment of proceeds to the transferor usually take place simultaneously.

If financial assets are securitised using a structured entity, then determining whether those financial assets should be derecognised may be a complex issue. In many securitisation transactions involving structured entities, the pass-through requirements would be difficult to achieve or would not be met. In addition, because the purpose of a securitisation is often to raise highly rated, low-cost finance, the transferor typically provides some form of credit enhancement to the structured entity. For example, the transferor may provide additional collateral to the structured entity in the form of loans or cash, or may provide a guarantee to the investors in the notes issued by the structured entity.

If a structured entity is used to securitise financial assets, then the derecognition criteria may need to be analysed from different perspectives depending on the circumstances. The first step in the derecognition assessment is to assess whether the structured entity should be consolidated under IFRS 10, Consolidated Financial Statements.
Analysis of risks and rewards

Once an entity has established that it has transferred a financial asset either by transferring the contractual rights to receive the cash flows or under a qualifying pass through arrangement as discussed above, it carries out the risks and rewards test. This requires the entity to evaluate whether it has:

- transferred substantially all the risks and rewards of ownership of a financial asset
- retained substantially all such risks and rewards, or
- has neither transferred nor retained substantially all such risks and rewards.

In this case, the entity moves on to assess whether it has transferred control.

An entity derecognises an asset if it has transferred substantially all the risks and rewards of ownership of the asset. Conversely, an entity continues to recognise the asset if it has retained substantially all the risks and rewards of ownership of the asset.

A simplified example of transferring substantially all risks and rewards is an unconditional sale of a financial asset for a fixed consideration. Other examples would include sale of a financial asset together with an option to repurchase the same at its fair value at the time of repurchase, sale of a financial asset together with a put or call option that is deeply out of the money (i.e. an option that is so far out of the money that it is highly unlikely to go into the money before expiry).

**Substantially all the risks and rewards have been transferred**

Risks and rewards are measured as an entity’s exposure to the variability in cash flows from the transferred asset with greater weight being given to those outcomes that are more likely to occur. Therefore, for determining whether an entity has transferred or retained substantially all the risks and rewards, the entity would need to undertake a quantitative evaluation of the variability in cash flows from the transferred asset.

As part of such evaluation, an entity needs to compute and compare the entity’s exposure before and after the transfer to the variability in the amounts and timing of the net cash flows of the transferred asset. If the entity’s exposure to such variability is no longer significant in relation to the total variability associated with the financial asset, the entity is regarded as having transferred substantially all the risks and rewards.

Analysis of control and continuing involvement

‘Control’ from the stand point of the transferee: In case an entity has neither transferred nor retained substantially all risks and rewards, then for the purpose of evaluating derecognition one needs to ascertain whether the entity has transferred control. In the context of derecognition under IAS 39, “control” is based on whether the transferee has the practical ability to sell the asset.
The standard highlights that if the transferee has the practical ability to sell the asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without needing to impose additional restrictions on the transfer, the entity (transferor) has not retained control. In all other cases, the entity/transferor has retained control and continues to recognise the asset to the extent of its continuing involvement.

For example, an entity (the transferor) may transfer a security with an option (neither deeply in nor out of the money) attached that allows the entity to repurchase the security at a future date. If there is an active market in the security, the transferee is able to sell the security to a third party, knowing that it will be easy to obtain a replacement asset and fulfil its obligation if the transferor exercises the option. If there is no market, as is commonly the case for loans and receivables, the transferee is unable to ensure that it can fulfil its obligation to return the asset to the transferor if it sells the asset with no right to repurchase it. Whether the transferee intends to sell the transferred asset is of no relevance as long as it has the practical ability to do so.

Under the continuing involvement approach, the entity continues to recognise part of the asset which represents the extent of its continuing exposure to the risks and rewards of the asset. In other words, the concept of continuing involvement results in partial derecognition with an amount that continues to be recognised as an asset being mirrored by a gross liability in the financial statements of the transferor entity.

For example, an entity (transferor) transfers its mortgage portfolio to a buyer, the portfolio has historically had average credit losses to the tune of five per cent. The transferor guarantees the first four per cent of credit losses.

The main principle of continuing involvement is to reflect on the balance sheet the maximum amount of exposure that an entity (transferor) has to a particular asset that was transferred. In case, where a guarantee is the cause of the continuing involvement, the continuing involvement asset is measured at the lower of the carrying amount of the asset and the maximum amount the entity could be required to pay under the guarantee.

**Key notes**

- Usually, a transferor is deemed to have retained control of the transferred asset, if such asset is not traded in a market. The underlying philosophy here is that if there is no active or traded market for the transferred asset, it essentially indicates a practical inability on part of the transferee to sell such an asset.

**Continuing involvement:** Continuing involvement approach applies if the entity has neither transferred nor retained substantially all the risks and rewards of ownership and control has not passed to the transferee. The assumption here is that: (i) there has been a transfer of asset, (ii) an analysis of risks and rewards indicates that the transferor has neither transferred nor retained substantially all the risks and rewards, and (iii) control remains with the transferor. Therefore, the transaction is being accounted for under continuing involvement.

**Derecognition of a financial liability**

An entity shall remove a financial liability (or a part of a financial liability) from its balance sheet when, and only when, it is extinguished i.e. when the obligation specified in the contract is discharged, cancelled or expired.

An exchange between an existing borrower and lender of debt instruments with substantially different terms shall be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. Similarly, a substantial modification of the terms of an existing financial liability or a part of it (whether or not attributable to the financial difficulty of the borrower) shall be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

**Key notes**

- A step by step approach to evaluate whether a transaction qualifies for derecognition is essential in reaching an appropriate conclusion. The assessment and conclusion on the three components of the decision grid are critical – risk and rewards, control and continuing involvement.

- The notion of ‘control’ in context of IAS 39 is different from the notion of control in IFRS 10, Consolidated Financial Statements (i.e. exposure to variability in returns of investee and ability to affect those returns). In the context of derecognition under IAS 39, ‘control’ is based on whether the transferee has the practical ability to sell the asset

- Continuing involvement in an asset will include both obligations to support the risks arising from the asset’s cash flows (e.g. if a guarantee has been provided) and the right to receive benefits from these cash flows.
Income taxes
- Applicability of tax rate in the interim financial results

This article aims to:

- Discuss the application of AS 25 principles and key challenges that companies may encounter while recognising the income tax expense in preparing its interim financial information.
As per the requirements of the Clause 41 of the Equity Listing Agreement issued by the Securities and Exchange Board of India (SEBI), all listed companies are required to submit their quarterly and year to date financial results to the stock exchange. One of the key aspects to be considered by companies while submitting such results is the computation of income tax expenditure for such interim periods. The principles for recognition and measurement of tax expense relating to an interim period are laid down in AS 25, *Interim Financial Reporting*. Additionally, the Institute of Chartered Accountants of India (ICAI) has in the past issued a Guidance Note on *Applicability of AS 25 to Interim Financial Results* (guidance note). On 5 September 2014, the Expert Advisory Committee* (EAC) of the ICAI published its opinion on the topic *Applicability of Tax Rate in the Quarterly Financial Results*. The EAC through its opinion has clarified the requirements of AS 25 and its applicability on quarterly financial results.

This article aims to discuss the application of AS 25 principles and key challenges that companies may encounter while recognising the income tax expense in preparing its interim financial information, in light of the above mentioned EAC opinion.

**Principles of AS 25**

As per para 27 of the AS 25 ‘an enterprise should apply the same accounting policies in its interim financial statements as are applied in its annual financial statements, except for accounting policy changes made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statements. However, the frequency of an enterprise’s reporting (annual, half-yearly, or quarterly) should not affect the measurement of its annual results. To achieve that objective, measurements for interim reporting purposes should be made on a year-to-date basis.’

A company may choose to prepare interim financial information either on a quarterly or a half yearly basis unless as specified by a regulator e.g. SEBI. However, such preparation of interim financial information should not affect the measurement of its annual results.

Para 29 of AS 25 states that ‘income tax expense is recognised in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year. Amounts accrued for income tax expense in one interim period may have to be adjusted in a subsequent interim period of that financial year if the estimate of the annual income tax rate changes.’

Therefore, income tax expense for an interim period is calculated by applying, to an interim period’s pre-tax income, the tax rate that would be applicable to expected total annual earnings, that is, the estimated average annual effective income tax rate. A company would estimate an average annual income tax rate that would be applicable to the full year’s earnings i.e. take the impact of changes in the enacted or substantially enacted income tax rates expected to be applicable to the annual results. Accordingly, anticipated tax deductions and exemptions for the full year, effect of tax losses carried forward, etc. are few of the items to be considered for estimating average annual effective income tax rate.

Para 30 (c) of IAS 34 and Ind AS 34 state that ‘income tax expense is recognised in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year. Amounts accrued for income tax expense in one interim period may have to be adjusted in a subsequent interim period of that financial year if the estimate of the annual income tax rate changes.’

As evident from the above, the principles of IAS 34 and Ind AS 34 are similar to that of AS 25, so far as it relates to the measurement and recognition of income tax expense during an interim period.

The guidance under FASB ASC 740 (U.S. Generally Accepted Accounting Principles) is also largely similar to IFRS, Indian GAAP and Ind AS.

**Applicability of AS 25 to quarterly financial results**

As per sub-clause (v) of Clause 41 of the Equity Listing Agreement, quarterly and year to date results of a company should be prepared in accordance with the recognition and measurement principles laid down in AS 25.

The EAC in its opinion noted that the Equity Listing Agreement specifically requires the quarterly and year to date results to be prepared in accordance with the principles of AS 25. Further, the EAC has clarified that even though the guidance note is recommendatory in nature, it does not lay down any new accounting principle and provides guidance on the application of AS 25. The EAC reiterated that AS 25 is a mandatory standard.

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How to practically apply the principles of recording income tax expense in interim periods?

The accounting requirements for recognising income tax expense in interim periods are based on the view that each interim period is an integral part of the annual period. Accordingly, income tax expense for interim periods is based on an annual effective income tax rate for the full year. In practice, companies will have to determine the estimated annual effective tax rate to allocate the expected annual income tax expense to interim periods. This can be explained by way of an illustration:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Current tax charge</th>
<th>Deferred tax asset</th>
<th>Combined</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Estimated for the year ended March 2015)</td>
<td>INR</td>
<td>INR</td>
<td>INR</td>
</tr>
<tr>
<td>Estimated annual taxable income before any adjustments</td>
<td>30,000</td>
<td>-</td>
<td>30,000</td>
</tr>
<tr>
<td>Non-deductible expenses (permanently disallowed)</td>
<td>1,000</td>
<td>-</td>
<td>1,000</td>
</tr>
<tr>
<td>Estimated timing/temporary differences resulting in deferred tax consequences (for example: deductions under Section 43B of the Income Tax Act, 1961)</td>
<td>10,000</td>
<td>(10,000)</td>
<td>-</td>
</tr>
<tr>
<td>Total</td>
<td>41,000</td>
<td>(10,000)</td>
<td>31,000</td>
</tr>
<tr>
<td>Enacted tax rate per tax laws</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Estimated annual tax expense/(credit) (p)</td>
<td>35%</td>
<td>35%</td>
<td>35%</td>
</tr>
<tr>
<td>Estimated annual taxable income (q)</td>
<td>14,350</td>
<td>(3,500)</td>
<td>10,850</td>
</tr>
<tr>
<td>Estimated annual effective tax rate (a) = [(p)/(q)]</td>
<td>47.83%</td>
<td>-11.67%</td>
<td>36.17%</td>
</tr>
</tbody>
</table>

Assuming that the company earns a taxable income of INR8,000 in the quarter ended June 2014, it will determine the current tax and deferred tax asset as follows:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Current tax charge</th>
<th>Deferred tax asset</th>
<th>Combined</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxable profit before tax (b)</td>
<td>8,000</td>
<td>8,000</td>
<td>8,000</td>
</tr>
<tr>
<td>Tax charge/(credit) to be recorded in the interim period [(a) X (b)]</td>
<td>3,827</td>
<td>(933)</td>
<td>2,894</td>
</tr>
</tbody>
</table>

Source: KPMG in India analysis

While the principles are clearly laid down in AS 25, there could be some practical challenges that the companies may encounter in applying this guidance that are discussed in detail below:

**Extraordinary items, effect of changes in accounting policies and significant unusual items**

Interim period income tax expense is accrued using the tax rate that would be applicable to expected total annual earnings, that is, the estimated average annual effective income tax rate applied to the pre-tax income of the interim period. The rate is the ratio of estimated annual income tax expense to estimated pre-tax income. In order to recognise, measure, classify, or disclose an item for interim financial reporting purposes, materiality should be assessed in relation to the interim period financial data. Judgement should be applied in assessing materiality for financial reporting purposes. Thus, for example, unusual or extraordinary items, changes in accounting policies or estimates, and prior period items are recognised and disclosed based on materiality in relation to interim period data.
Tax deductions/exemptions

Tax statutes may provide deductions/exemptions in computation of income for determining tax payable. Anticipated tax benefits of this type for the full year are generally reflected in computing the estimated annual effective income tax rate, because these deductions/exemptions are calculated on an annual basis under the usual provisions of tax statutes. On the other hand, tax benefits that relate to a one-time event are recognised in computing income tax expense in that interim period, in the same way that special tax rates applicable to particular categories of income are not blended into a single effective annual tax rate.

Tax loss carryforwards

A deferred tax asset should be recognised in respect of carryforward tax losses to the extent that it is virtually certain, supported by convincing evidence, that future taxable income will be available against which the deferred tax assets can be realised. The criteria are to be applied at the end of each interim period and, if they are met, the effect of the tax loss carryforward is reflected in the computation of the estimated average annual effective income tax rate.

Interaction with Income Computation and Disclosure Standards (ICDS)

The Ministry of Finance has issued Income Computation and Disclosure Standards (ICDS) which are applicable from 1 April 2015. These standards outline the specific rules that can enable computation of taxable income with certainty and clarity. Companies should consider the provisions of ICDS in determining the tax computation for interim periods as the new rules could significantly differ from those hitherto applied in determination of tax charge.

Conclusion

The EAC has clarified through its opinion that the Equity Listing Agreement mandates compliance with AS 25 for preparation of interim results. Accordingly, the measurement and recognition of income tax expense for an interim period should be governed by the principles of AS 25, which is along the same lines as that of IAS 34 and Ind AS 34. This means that while preparing interim financial information, companies need to compute its estimated annual taxable income and arrive at the estimated annual effective income tax rate. Also, based on the facts and information available, companies may need to revisit the estimated annual effective tax rate at each interim period for computation of its income tax expense.
Ind AS 17, Accounting for leases

This article aims to:

- Provide an overview of the changes that are proposed to be introduced on lease accounting with Ind AS implementation in India
- Briefly discuss the status of the IASB - FASB convergence project on lease accounting
- Highlight the area of difference between Ind AS and IFRS.
Background and setting the context

Taking assets on lease has become an essential part of today’s business world with almost every company entering into lease transactions, for instance, taking office space on rental, lease of equipments, vehicles, etc. Under current Indian GAAP, AS 19, Leases provides the requisite guidance on accounting for leases. Under Indian Accounting Standards (Ind AS), the corresponding standard on this topic is Ind AS 17, Leases.

While both standards are similar in many aspects such as classification criteria, accounting rules, there are certain areas where either there are subtle differences or where Ind AS provides additional guidance which is not available under Indian GAAP. The subsequent paragraphs capture the current accounting practices and how these would undergo a change once Ind AS is implemented in India.

Key impact areas on Ind AS implementation

Lease of land

Under current Indian GAAP, AS 19 specifically excludes lease of land from its scope. Accordingly, there is no authoritative accounting standard under current Indian GAAP which governs the accounting for leases of land and hence varied practices exist. It is a common practice for companies to reflect the upfront payments for long-term leases of land as part of their fixed assets.

Unlike current Indian GAAP, Ind AS 17 does not exclude lease of land from its scope and hence like any other leased asset, an entity would apply the classification criteria provided in the standard to determine whether a land lease would qualify to be an operating lease or a finance lease. An important consideration to determine the classification of a land is that it has an indefinite economic life. Thereby while it may be argued that even in a long-term lease of land the lease term is normally shorter than the economic life of the land and hence it would not classify as a finance lease. However, other lease classification criteria under Ind AS 17 should be considered. Ultimately, lease classification is based on an overall assessment of whether substantially all the risks and rewards incidental to ownership of the asset have been transferred from the lessor to the lessee. Hence, under Ind AS regardless of whether the title is transferred, long-term lease of land (multiple decades such as a 99 years lease) would be treated as a finance lease. This is due to the fact that significant risks and rewards associated with the land during the lease term are transferred to the lessee during the lease term, regardless of whether title will be transferred and the present value of the residual value of the land with a lease term of ‘several decades’ would be negligible and therefore accounting for the land element as a finance lease is consistent with the economic position of the lessee. Conversely, a short lease of land is unlikely to be a finance lease because the risks and rewards retained by the lessor through its residual interest in the land at the end of the lease when measured at inception are likely to be significant.

Initial direct costs incurred by lessors

Initial direct costs are incremental costs often incurred by lessors in connection with specific leasing activities, such as negotiating and securing lease arrangements. Under Indian GAAP, for both finance (other than those involving manufacturer or dealer lessors) and operating leases, AS 19 provides a policy choice to lessors to either expense the initial direct costs immediately or add them to the finance lease receivable (in case of finance lease) or the leased asset (in case of operating lease).

Ind AS 17 does not permit immediate expensing of these costs and hence these costs need to be added to the finance lease receivable (in case of finance lease) or the leased asset (in case of operating lease) which would then be charged to the statement of profit and loss over the lease term.

Embedded leases

Currently under Indian GAAP, there is no guidance to identify and account lease transactions that may be embedded in purchase/sale arrangements that do not take the legal form of lease. Appendix C of Ind AS 17 envisages arrangements that do not take the legal form of lease but convey the right to use an asset in return for a payment or series of payments (commonly referred to as ‘embedded leases’). The examples provided in the standard for such arrangements are:
- outsourcing of the data processing functions of an entity
- arrangements in the telecommunications industry, in which suppliers of network capacity enter into contracts to provide purchasers with rights to capacity
- take-or-pay and similar contracts such as power supply arrangements, in which purchasers of power must make specified payments regardless of whether they take delivery of the contracted products or services (power in this case) from an identified power generator.

Once an arrangement is identified as a lease, then the general criteria for classification as an operating or finance lease prescribed under Ind AS 17 would apply.

The following example further explains the concept of an embedded lease arrangement:

A thermal power generating company (company) enters into a long-term arrangement with a state electricity board (Board) for supply of power as per which the company contracts to supply the entire power generated from an identified power plant to the Board for a fixed price of INR5 per unit of power. In case of any shortfall in procurement of the power generated, the Board will compensate the company at the rate of INR5 per unit of shortfall. Currently under Indian GAAP, this would be treated as a normal purchase/sale transaction at INR5 per unit and the payment on account of a shortfall would be treated as a penalty. Under Ind AS, as the company supplies the entire power generated from an identified power plant to the Board and the pricing is on a take-or-pay basis, this arrangement would qualify to be an embedded lease of the power plant and hence, payment would need to be split between two components – lease of the power plant from the company to the Board and sale of power.

Applying the guidance provided under Ind AS 17, the embedded lease may qualify...
to be an operating or a finance lease. In case the arrangement qualifies to be a finance lease, the asset would need to be derecognised from the books of the company and the lease payments received would need to be allocated to the finance lease receivable and the remaining towards sale of power. The Board would correspondingly recognise the asset on its books with a split of the payments made towards settlement of the finance lease obligation and payment for purchase of power. In case of an operating lease classification, the consideration would be split between purchase/sale of power and lease expense/income by the Board and the company respectively.

Operating lease incentives
Lessors commonly provide lease incentives to lessees at the time of negotiating a new or renewing an existing lease arrangement such as an initial rent free period, reimbursement of certain expenses incurred by the lessee in relation to the lease, etc. Currently there is no specific guidance under Indian GAAP for operating leases incentives under AS 19 and hence, varied practices exist.

Ind AS 17 states that lease incentives should be recognised as an integral part of the net consideration agreed for the use of the leased asset. Hence, the aggregate cost and benefit of the lease incentives for the lessor and the lessee respectively would be recognised by way of a reduction of the lease income and expense on a straight-line basis unless another systematic basis is representative of the time pattern over which the benefit from the leased asset is obtained.

Lease security deposits
Currently under Indian GAAP, lease security deposits (that are refundable in cash on completion of the lease term) are recorded at their transaction value. As per Ind AS 109, Financial Instruments, all financial assets and liabilities are required to be recognised at fair value. Since lease security are refundable in cash, they would generally meet the definition of financial asset under Ind AS 109. As these security deposits are generally interest free, the difference between the deposit amount and the fair value would be treated as prepaid rentals which would then be recognised in the statement of profit and loss on a straight-line basis over the lease term as additional lease income and expense for the lessor and the lessee respectively.

Straight lining of lease rentals
Both current Indian GAAP and Ind AS require that the lease rentals in an operating lease arrangement should be recognised on a straight line basis unless another systematic basis is more representative of the time pattern over which the benefit from the leased asset is derived. Ind AS further states that straight-lining of rentals is not required if the payments to the lessor are structured to increase in line with expected general inflation to compensate for the lessor’s expected inflationary cost increases.

Status of the IASB-FASB convergence project on lease accounting
In response to long-standing criticisms on the existing lease standard being overly complex and dominated by arbitrary accounting distinctions for transactions that are economically similar, the International Accounting Standards Board (IASB) and the U.S. Financial Accounting Standards Board (FASB) decided to work on a joint project to develop a new standard on leases in 2006. The first exposure draft of the standard was issued in September 2010 and a revised exposure draft was issued in May 2013 (hereafter referred to as ‘ED’). The proposed standard aims to bring most leases on-balance sheet of lessees. The key principles of the ED are discussed below:

Lease identification – The ED defines lease as a contract that conveys the right to use an identified asset for a period of time in exchange for consideration. The right to control the use of the identified assets would be the key. A contract would convey these rights if the customer could both direct the use of the asset and derive substantially all the benefits from its use. If a single contract contains multiple lease and non-lease components, then the company would generally be required to account separately for each component.

Lease classification – The ED proposed to introduce new lease classification criteria resulting in a ‘dual model’ for both lessors and lessees. Type A leases where the underlying asset in most cases would not be property and would be treated similar to today’s finance leases – recognition of interest income/expense. Type B leases where the underlying asset in most cases would be property and would be treated similar to today’s operating leases – recognition of straight line income/expense.

Lessee accounting – A lessee would recognise a right-of-use (ROU) asset for the right to use the underlying asset with a corresponding lease liability for the obligation to make lease payments. Under both models, the lease liability would be amortised using the effective interest rate method. With respect to the ROU asset - under the Type A leases, the asset would generally be amortised on a straight-line basis and under the Type B leases, the asset would be recognised as a balance figure to achieve a straight-line profile of the total lease expense which would comprise of the interest expense and the amortisation of the asset.

Lessor accounting – For Type A leases, the lessor would apply the new, complex model which would result in derecognition of the underlying asset and recognition of a lease receivable and residual interest. For Type B leases, the lessor would continue to recognise the underlying asset and recognise lease income.

Short-term leases – The ED proposes to exclude leases which have a maximum lease term including renewal options of 12 months or less from its scope.

1. KPMG’s IFRS Newsletter LEASES, Issue 17, March 2015
Developments since the issue of the ED in 2013

Post issuance of the ED in 2013, both Boards had substantial deliberations on the proposals included in the ED with the significant ones being:

• the Boards decided jointly to abandon the lessor accounting proposals of the ED and it is expected that the key aspects of the current lessor accounting model will be retained;

• the Boards disagreed over the lessee accounting model with IASB advocating a single lessee accounting model and FASB insisting on a dual model.

While there have been several deliberations, the key message from the project remains unchanged which is to bring leases on the balance sheet of lessees.

The key highlights from the other discussions are summarised below:

a. Both Boards concluded their discussions on the definition of a lease and agreed on a fully converged definition

b. The IASB decided to include a small-ticket exemption in the new standard to reduce the compliance cost for leases that are small in value and/or secondary to a company’s business operations. It is expected that the value of the underlying assets for this exemption would be of value USD5,000 or less. The FASB did not approve a specific scope exemption for small-ticket leases.

c. The Boards have decided to introduce a new, optional transition relief permitting companies to ‘grandfather’ their assessment of which contracts in place at the time of initial application of the new standard are, or contain, leases. If a company chooses to apply the grandfathering approach, then it would apply this approach to all contracts in place at the time of initial application with disclosure of the approach taken.

d. The Boards agreed to retain the overall disclosure objective from the ED but disagreed on the detailed qualitative and quantitative information that a lessee would be required to disclose.

In March 2015, the project reached a significant milestone with both the IASB and the FASB deciding to prepare non-converged ballot drafts of their new standards on lease accounting which provides further proof that the Boards have decided to proceed with different lease accounting models.

It is expected that the Boards will issue their respective new standards by the end of 2015 but have not yet discussed an effective date.

Key difference between Ind AS 17 and IAS 17

There is only one material difference between Ind AS 17 and IAS 17. Ind AS 17 provides an exemption from straight-lining of rentals for operating lease arrangements if the payments to the lessor are structured to increase in line with expected general inflation to compensate for the lessor’s expected inflationary cost increases. Under IAS 17, there is no such exemption and hence inflation related escalations would also need to be factored in the straight-lining computations.
Accounting treatment of liquidated damages under a contract

This article aims to:

- Provide an overview on the accounting treatment of liquidated damages under a contract under Indian GAAP and the corresponding impact under Ind AS 115.
Background

Under the current Indian GAAP, there is no specific guidance on accounting treatment of liquidated damages under a contract i.e. the credits given to the customers for delay in delivery as per the contracted delivery schedule. These credits can be in the form of rebate against purchase price of the product, marketing support, spare parts support at reduced or zero charge, discounts for future purchases, etc. Therefore, a question arises on when such credits recognised in the statement of profit and loss immediately or reduced from the revenue from such products or services.

Method of accounting

As per paragraph 9.2 of AS 9, Revenue Recognition, which states that, ‘where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, e.g., for escalation of price, export incentives, interest, etc., revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognise revenue only when it is reasonably certain that the ultimate collection will be made. Where there is no uncertainty as to ultimate collection, revenue is recognised at the time of sale or rendering of service even though payments are made by instalments.’

Accordingly, a company would have to consider the facts and circumstances of each case and understand the substance of such credits given to the customers. Recently, the Expert Advisory Committee (EAC) of the Institute of Chartered Accountants of India (ICAI) has issued an opinion on ‘Accounting Treatment of Liquidated Damages on Unexecuted Portion of Contract’.

A company may have a sales contract to supply goods to a customer as per an agreed schedule of delivery. When a portion of the contracted supplies is delayed, a customer can impose liquidated damages on the company. In the case discussed by the EAC, it referred to AS 29, Provisions, Contingent Liabilities and Contingent Assets, AS 1, Disclosure of Accounting Policies and the Framework for Preparation and Presentation of Financial Statements for accounting guidance. It noted that liquidated damages are recovered by the customers for the period of delay between the due date of supply of goods as per the delivery schedule and the actual date of delivery of the said goods. Further, in this particular case, there was no clause in the contract to exit from the sales contract(s) entered with the customer, with or without the payment of penalty and the past experience of the company shows that in most cases, although the customers extend the due date of supply, the liquidated damages were recovered in full.

Accordingly, the EAC is of the view that the terms and conditions of the sales contract(s) are binding and legally enforceable by the customers.

The EAC took the view that the liquidated damages are akin to penalty and there is a contractual obligation on the part of the company to pay for liquidated damages as soon as there is a delay in the supply of goods beyond the due date as per the delivery schedule. Further, this obligation cannot be avoided by the company’s future course of actions as it does not have any realistic alternative but to settle the contractual obligation (i.e. making the payment of such liquidated damages).

Thus, there exists a present obligation arising from past event, viz., delay beyond scheduled delivery and settlement of which is expected to result in an outflow of resources embodying economic benefits.

Accordingly, in this case the company should recognise a provision in respect of liquidated damages for the period of delay between the due date of supply of goods as per the delivery schedule and the expected date of delivery of the said goods and not only for the period of delay till the date of financial statements, in the light of evidence provided by events occurring after the balance sheet date, as per paragraph 36 of AS 29.

Accounting treatment under Ind AS 115, Revenue from Contracts with Customers

Accounting treatment under Ind AS 115, Revenue from Contracts with Customers follows a new approach i.e. revenue is recognised to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for such products or services following a five step model as follows:

- **Step 1** - Identify the contract with the customer
- **Step 2** - Identify the performance obligations in the contract
- **Step 3** - Determine the transaction price
- **Step 4** - Allocate the transaction price to the performance obligation a in the contract
- **Step 5** - Recognise revenue when (or as) the entity satisfies a performance obligation.

Under the standard, the impact of ‘consideration payable to a customer’ is considered when determining the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding the amounts collected on behalf of third parties (for example, some sales taxes). The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both. The nature, timing and amount of consideration promised by a customer affect the estimate of the transaction price. An entity while determining transaction price, would be required to consider following:

  a. variable consideration (and the constraint)
  b. significant financing component
  c. non-cash consideration
  d. consideration payable to a customer.

Variable consideration: Under Ind AS 115 items such as discounts, rebates, refunds, rights of return, credits, price concessions, incentives, performance bonuses, penalties, or similar items may result in variable consideration.

If we further discuss step 3 i.e. Determine the transaction price in the present scenario, there is an element of variable consideration in the form of liquidated damages (penalties) which the company pays to its customers. Therefore, under Ind AS 115, penalties would be considered as a reduction of the transaction price.

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The company would have to at the end of each reporting period, update the estimated transaction price to represent the circumstances present at the end of the reporting period and the circumstances changed during the reporting period, if any.

It is important to note that the concept of variable consideration is expected to bring major changes to current practice of revenue recognition. The likely sectors which may be significantly affected by the above accounting treatment are aerospace and defence, software, and building and construction.

**Conclusion**

There is no authoritative or specific guidance for accounting of liquidated damages under the Indian GAAP. However, under Ind AS 115, a company would need to apply the five step model and accordingly recognise such penalties, while determining the transaction price. Under the Ind AS 115 model, a company would consider all the information as promised consideration can also vary if it is contingent on the occurrence or non-occurrence of a future event. Variability may be explicit or implicit, arising from customary business practices, published policies or specific statements, or any other facts and circumstances that would create a valid expectation by the customer.

Ind AS 115 introduces new estimates and judgemental thresholds that will affect the amount or timing of revenue recognised. Judgements and estimates will need updating, potentially leading to more financial statement adjustments for changes in estimates in subsequent periods.
Amendments to the consolidation analysis under U.S. GAAP

This article aims to:

– Provide an overview of the accounting update on new consolidation standard issued by the U.S. Financial Accounting Standards Board (FASB).
The FASB has issued an Accounting Standards Update (ASU) 2015-02, Amendments to the Consolidation Analysis on 18 February 2015. The ASU responds to stakeholders’ concerns about the current guidance for consolidation which might require a reporting entity to consolidate another legal entity in situations in which the reporting entity’s contractual rights do not give it the ability to act primarily on its own behalf, the reporting entity does not hold a majority of the legal entity’s voting rights, or the reporting entity is not exposed to a majority of the legal entity’s economic benefits or obligations.

In the past, the FASB has issued following related guidance:

**FASB Interpretation No. 46, Consolidation of Variable Interest Entities**

Required a reporting entity to consolidate a variable interest entity (VIE) if it was exposed to a majority of the VIE’s expected losses, expected residual returns, or both through its variable interests.

**Accounting Standards Update 2009-17, Improvement to financial reporting by enterprises involved with VIEs**

Reporting entity with a variable interest that provide the reporting entity with a controlling financial interest in a VIE will have both the following characteristics:

a. Power to direct the activities of a VIE that most significantly impact the VIE’s economic performance

b. Obligation to absorb losses or the right to receive benefits from the VIE that could potentially be significant to the VIE.

**ASU 2010-10, Consolidation (Topic 810), Amendments for Certain Investment Funds**

It is required that the entities meeting the deferral criteria should continue to apply the risk and rewards approach.

The amendments in this ASU affect reporting entities that are required to evaluate whether they should consolidate certain legal entities.

The amendments in this ASU affect the following areas:

1. More focus evaluation of limited partnerships and similar legal entities under the revised consolidation requirements that apply to variable interest entities (VIEs).
2. Evaluation of fees paid to a decision maker or a service provider as a variable interest
3. The effect of fee arrangements on the primary beneficiary determination
4. The effect of related parties on the primary beneficiary determination
5. Certain investment funds.

These amendments have been discussed in this article.

**Limited partnerships and similar legal entities**

The amendments in this ASU have the following three main provisions that affect limited partnerships and similar legal entities:

1. There is an additional requirement that limited partnerships and similar legal entities should meet to qualify as voting interest entities. A limited partnership must provide partners with either substantive kick-out rights or substantive participating rights over the general partner to meet this requirement.
2. The specialised consolidation model and guidance for limited partnerships and similar legal entities have been eliminated. There is no longer a presumption that a general partner should consolidate a limited partnership.
3. For limited partnerships and similar legal entities that qualify as voting interest entities, a limited partner with a controlling financial interest should consolidate a limited partnership. A controlling financial interest may be achieved through holding a limited partner interest that provides substantive kick-out rights.

**Evaluating fees paid to a decision maker or a service provider as a variable interest**

The ASU defines a decision maker as ‘an entity or entities with the power to direct the activities ....that most significantly impact (a) legal entity’s economic performance...’

The current standard had six conditions which should be evaluated to assess whether fees paid by a legal entity to a decision maker or a service provider represent a variable interest in the legal entity. The ASU has eliminated the following three conditions:

- Substantially all of the fees are at or above the same level of seniority as other operating liabilities of the VIE that arise in the normal course of the VIE’s activities, such as trade payables
- The total amount of anticipated fees are insignificant relative to the total amount of the VIE’s anticipated economic performance
- The anticipated fees are expected to absorb an insignificant amount of the variability associated with the VIE’s anticipated economic performance.

As per the ASU, the following three conditions have to be met for fees paid to a legal entity or decision maker or service provider for not being considered as variable interests:

- The fees are compensation for services provided and are commensurate with the level of effort required to provide those services
- The decision maker or service provider does not hold other interests in the VIE that individually, or in the aggregate, would absorb more than an insignificant amount of the VIE’s expected losses or receive more than an insignificant amount of the VIE’s expected residual returns
- The service arrangement includes only terms, conditions, or amounts that are customarily present in arrangements for similar services negotiated at an arm’s length.

1. Sources: FASB ASU 2015-02 and KPMG’s Defining Issues No. 15-6, February 2015
As per the ASU, facts and circumstances should be considered when assessing the conditions specified in relation to fees paid to decision makers or service providers not being considered variable interests.

An arrangement that is designed in a manner such that the fee is inconsistent with the decision maker’s or service provider’s role or the type of service would not meet the above mentioned conditions. To assess whether a fee meets those conditions, a reporting entity may need to analyse similar arrangements among parties outside the relationship being evaluated. However, a fee would not presumptively fail the said conditions if similar service arrangements do not exist in the following circumstances:

a. The fee arrangement relates to a unique or new service
b. The fee arrangement reflects a change in what is considered customary for the services.

In addition, the magnitude of a fee, in isolation, would not cause an arrangement to fail the conditions.

Fees or payments in connection with agreements that expose a reporting entity (the decision maker or the service provider) to risk of loss in the VIE would not be eligible for the evaluation of the conditions specified in relation to fees paid to decision makers or service providers not being considered as variable interest. Those fees include, but are not limited to, the following:

a. Those related to guarantees of the value of the assets or liabilities of a VIE
b. Obligations to fund operating losses
c. Payments associated with written put options on the assets of the VIE
d. Similar obligations, such as some liquidity commitments or agreements (explicit or implicit) that protect holders of other interests from suffering losses in the VIE.

The primary beneficiary consolidates a VIE because it has a controlling financial interest.

Under the requirements in current U.S. GAAP, if a fee arrangement paid to a decision maker, such as an asset management fee, is determined to be a variable interest in a VIE, the decision maker must include the fee arrangement in its primary beneficiary determination and could consolidate the VIE on the basis of power (decision-making authority) and economics (the fee arrangement).

However, the ASU specifies that some fees paid to a decision maker are excluded from the evaluation of the economics criterion if the fees are both customary and commensurate with the level of effort required for the services provided. Those amendments make it less likely for a decision maker to meet the economics criterion solely on the basis of a fee arrangement.

The effect of related parties on the primary beneficiary determination

As per the ASU if no single party has a controlling financial interest in a VIE, interests held by a reporting entity’s related parties should be treated as though they belong to the reporting entity when evaluating whether a related party group has the characteristics of a primary beneficiary.

The ASU reduces the application of the related party guidance for VIEs on the basis of the following three changes:

1. For single decision makers, related party relationships should be considered indirectly on a proportionate basis, rather than in their entirety. Except in the following two instances, the consolidation analysis would end after this indirect assessment
2. After the assessment above is performed, related party relationships should be considered in their entirety for entities that are under common control only if that common control group has the characteristics of a primary beneficiary. That is, the common control group collectively has a controlling financial interest
3. If the second assessment (above) is not applicable, but substantially all of the activities of the VIE are conducted on behalf of a single variable interest holder (excluding the decision maker) in a related party group that has the characteristics of a primary beneficiary, that single variable interest holder should consolidate the VIE as the primary beneficiary.

Certain investment funds

The ASU provide a scope exception from Topic 810, Consolidation for reporting entities with interests in legal entities that are required to comply with or operate in accordance with requirements similar to those in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds.
Differences as compared to International Financial Reporting Standards (IFRS)

IFRS 10, *Consolidated Financial Statements*, has a single model that defines the principle of control and establishes control as the basis for determining which entities are consolidated. U.S. GAAP has two different models for determining controlling financial interests that are based on whether the entity under evaluation is a VIE or a voting interest entity. The definition of control in IFRS 10 includes the principle commonly referred to as effective control, while the models in the U.S. GAAP include the principle of controlling financial interests for VIEs and voting interest entities. The definition of control may differ between IFRS and U.S. GAAP because the principles of effective control and controlling financial interest are not always consistent.

For example, one of the aspects of control under IFRS 10 is that an entity should have the ability to use its power over the investee to affect the amount of the investor’s returns. IFRS 10 provides factors to consider in making that assessment, which include (but are not limited to) the scope of decision-making authority and the magnitude and variability of the decision-maker’s compensation relative to the expected returns of the entity.

The ASU provides guidance for determining when fees paid to a decision maker are a variable interest and when the decision maker is the primary beneficiary. The scope of the decision maker’s authority and the magnitude of the compensation are factors considered in IFRS and U.S. GAAP but may not be considered in the same manner when determining whether a variable interest exists or when identifying a primary beneficiary under U.S. GAAP.

The ASU also provides guidance for identifying the primary beneficiary that varies depending on whether there is a single decision maker or shared power and depending on whether the related parties (and de facto agents) are under common control with the reporting entity. IFRS does not contain such concepts.

IFRS 10 includes a principal vs. agent analysis as one of three criteria for having control over an investee in its consolidation model. The ASU does not provide a principal vs. agent analysis; rather, the evaluation is integrated within the determination of a controlling financial interest.

Accordingly, the ultimate consolidation conclusion may be different under U.S. GAAP and IFRS for certain facts and circumstances.

Effective date of ASU

The ASU is effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after 15 December 2015. For all other entities, the ASU is effective for fiscal years beginning after 15 December 2016 and for interim periods within fiscal years beginning after 15 December 2017. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period.

A reporting entity may apply the amendments using a modified retrospective approach by recording a cumulative-effect adjustment to equity as of the beginning of the fiscal year of adoption. A reporting entity also may apply the amendments retrospectively.

The IASB issues a formal proposal to defer the effective date of the new revenue standard

This article aims to:

- Provide an update on the proposal of the International Accounting Standards Board (IASB) to defer the effective date of IFRS 15, Revenue from Contracts with Customers.
Background
On 28 April 2015, the International Accounting Standards Board (IASB) had voted to publish an exposure draft (ED) proposing a one-year deferral of the effective date of IFRS 15, Revenue from Contracts with Customers to 1 January 2018.

New development
On 19 May 2015, the IASB published an ED of proposed amendments to IFRS 15 to propose changing the effective date of IFRS 15. It proposes that IFRS 15 would apply for annual reporting periods beginning on or after 1 January 2018. Earlier application would continue to be permitted. Entities would also continue to be permitted to choose between applying the standard either retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying the standard recognised at the date of initial application.

The IASB and FASB Joint Transition Resource Group have discussed a number of application issues. In light of those issues, the IASB has tentatively decided to propose amendments to IFRS 15 which are expected to clarify, instead of change, the requirements of the standard. These amendments will be included in an ED to be published later in 2015. These amendments are expected to include:

• Clarification to the guidance on licences
• Addition of examples illustrating the guidance on identifying performance obligations, and
• Clarifications to the guidance on principal vs agent considerations.

In the light of the above proposed amendments, the IASB discussed whether it should propose to defer the effective date of IFRS 15. The Financial Accounting Standards Board (FASB), however, has issued an ED on deferral of the effective date of Topic 606, Revenue from Contracts with Customers (equivalent to IFRS 15) on 29 April 2015 with comments due by 29 May 2015.

The IASB had also received a number of unsolicited comment letters from stakeholders, e.g. telecommunication and software industries, supporting a deferral of the effective date of IFRS 15. In their view, a one-year deferral would improve the quality of implementation, particularly in the light of the availability (or lack thereof) of information technology systems.

Therefore, the IASB hold a view that a one-year deferral is sufficient in terms of providing additional time to implement IFRS 15.

Feedback on the ED is required by 3 July 2015.

Accordingly, the IASB would also consider the comments it receives on the proposal and would plan to decide whether to proceed with an amendment to IFRS 15 regarding the effective date at its July 2015 meeting.

Impact on Ind AS roadmap
We note that the proposal of the IASB for a one-year deferral of the effective date of the revenue standard does not automatically mean deferral of the Ind AS 115, Revenue from Contracts with Customers issued by the Ministry of Corporate Affairs (MCA). Ind AS 115 is aligned to IFRS 15.

(Source – KPMG’s IFRS Notes dated 21 May 2015)
The ICAI issues a guidance note on accounting for derivative contracts

This article aims to:

- Provide an overview of the recently issued guidance note on accounting for derivative contracts by the Institute of Chartered Accountants of India (ICAI).
History of authoritative guidance on derivative accounting in India

- In 2007, the ICAI issued AS 30, Financial Instruments: Recognition and Measurement and AS 31, Financial Instruments: Presentation which were recommendatory in nature for an initial period of two years. Both these standards were to be effective from accounting periods commencing on or after 1 April 2011. While these standards provide persuasive guidance, they have not been made mandatory for application by companies till date.

- In March 2008, the ICAI issued an announcement relating to the accounting of derivatives. According to the announcement, if an entity did not follow AS 30, keeping in view the principle of prudence as stated in AS 1, Disclosure of Accounting Policies, the entity was required to provide for losses in respect of all outstanding derivative contracts at the balance sheet date by marking them to market. This became applicable for financial statements for the period ended 31 March 2008, or thereafter. In case of forward contracts to which AS 11, The Effects of Changes in Foreign Exchange Rates, applies, entities need to fully comply with the requirements of AS 11.

- Currently, prior to the issuance of the guidance note, the relevant source of guidance for accounting of foreign currency forward exchange contracts is AS 11, which is notified under the Companies (Accounting Standards) Rules, 2006. AS 11 lays down accounting principles for foreign currency transactions and foreign exchange forward contracts and in substance similar contracts. However, it does not cover all types of foreign exchange forward contracts since contracts used for hedge highly probable forecast transactions and firm commitments are outside the scope of AS 11.

Scope: key aspects of the guidance note

The guidance note covers all derivative contracts that are not covered by an existing notified accounting standard. It also provides guidance on accounting of assets covered by AS 2, Valuation of Inventories, AS 10, Accounting of Fixed Assets, AS 13, Accounting for Investments, etc. which are designated as hedged items, since such notified accounting standards are silent on hedge accounting using derivative instruments for items covered by these standards. Accordingly, guidance for accounting for derivatives and hedging relationships which pertain to hedged items covered under such notified accounting standards, e.g. a commodities stock, fixed assets, investments, etc. is provided in this guidance note. AS 11 continues to provide guidance specific to foreign currency forward contracts.

The guidance note applies to following derivative contracts whether or not used as hedging instruments:

- Foreign exchange forward contracts (or other financial instruments that are in substance forward contracts) that are hedges of highly probable forecast transactions and firm commitments (therefore, outside the scope of AS 11)
- Other foreign currency derivative contracts such as cross currency interest rate swaps, foreign currency futures, options and swaps not in the scope of AS 11
- Other derivative contracts such as traded equity index futures, traded equity index options, traded stock futures and option contracts, and Commodity derivative contracts.

This list is meant to be illustrative only and is not exhaustive.

Scope exclusions

The guidance note does not apply in the following cases:

- Foreign exchange forward contracts covered under AS 11 e.g.,
  - foreign currency forward or future contract entered into to hedge the payment of a monetary asset or a monetary liability recognised on balance sheet e.g. a debtor, creditor, loan, borrowing, etc.
  - a currency swap contract (principal only; no interest rate element) that hedges the repayment of the principal of a foreign currency loan

- Derivatives that are covered by regulations specific to a sector or specified set of entities e.g. entities such as banking, non-banking finance companies (NBFCs), housing finance companies, insurance entities, etc., where the concerned regulator has prescribed accounting treatment for derivative contracts. If the concerned regulator has not prescribed any accounting treatment for derivative contracts, the recommendations contained in the guidance note should be followed

- Accounting for embedded derivative contracts is not covered since there are potential conflicts with the requirements of certain other notified accounting standards such as AS 2, AS 13, etc.

- Entities that have adopted Indian Accounting Standards (Ind AS).

Accounting for derivatives

The guidance note includes definitions of various terms such as derivative, firm commitment, forecast transaction, hedging instrument, hedged item, hedge effectiveness, etc.

It requires all derivatives are recognised on the balance sheet and measured at fair value. Fair value in the context of derivative contracts represents ‘exit price’.

The guidance note defines exit price as the price that would be paid to transfer a liability or the price that would be received when transferring an asset to a knowledgeable, willing counterparty. The fair value would also incorporate the effect of credit risk associated with the fulfilment of future obligations. The extent and availability of collateral should be factored in while arriving at the fair value of a derivative contract.

The accounting for derivatives covered by this guidance note is based on the following principles:

I. All derivative contracts should be recognised on the balance sheet and measured at fair value

II. If any entity decides not to use hedge accounting as described in this guidance note, it should account for its derivatives at fair value with changes in fair value being recognised in the statement of profit and loss.
III. If an entity decides to apply hedge accounting as described in this guidance note, it should be able to clearly identify its risk management objective, the risk that it is hedging, how it will measure the derivative instrument if its risk management objective is being met and document this adequately at the inception of the hedge relationship and on an ongoing basis.

IV. An entity may decide to use hedge accounting for certain derivative contracts and for derivatives not included as part of hedge accounting, it will apply the principles at I and II above.

V. Adequate disclosures of accounting policies, risk management objectives and hedging activities should be made in its financial statements.

**Synthetic accounting**

The guidance note does not permit synthetic accounting i.e. accounting of combining a derivative and the underlying together as a single package. For instance, if any entity has a foreign currency borrowing that it has hedged by entering into a cross currency interest rate swap, it would require the entity to recognise the loan liability separately from the cross currency interest rate swap and not treat them as a package (synthetic accounting) as INR loan.

Alternatively, if any entity has borrowed in terms of INR which it swaps with foreign currency borrowing it would not treat such a loan as a foreign currency borrowing.

**Hedge accounting**

The guidance note provides detailed guidance in cases where an entity designates a derivative contract as a hedge instrument which is as follows:

- Designation of a derivative contract as a hedging instrument is optional. However, once it is applied, it needs to be based on the entity’s risk management objectives and goals and then cannot be subsequently turned off or on if the risk management objective remains the same
- Lays down minimum steps to be followed by an entity in cases where it designates a derivative contract as a hedge instrument.
- Clarifies that derivatives cannot be designated for a partial term of the derivative instrument
- Recognises three types of hedges and lays down accounting and measurement principles relating to (i) fair value hedge accounting model (ii) cash flow hedge accounting model, and (iii) net investment hedging
- Provides for elaborate documentation of hedge relationship at inception of a hedge and must include descriptions as prescribed in the guidance note
- Prescribes that an entity should assess whether a hedging relationship meets the hedge effectiveness requirements. At a minimum, an entity should perform the ongoing assessment at each reporting date or when there is a significant change in the circumstances that affect hedge effectiveness requirements, whichever comes first
- Does not prescribe bright-line tests for effectiveness assessments; instead requires disclosure of the entities risk management objectives and measures for assessing, if these objectives are met
- Does not prescribe a single method of how ineffectiveness measurement should be conducted other than to require an entity to consider how ineffectiveness could affect a hedging relationship and require immediate recognition of such ineffectiveness
- Prohibits voluntary hedge de-designation if risk management objectives and hedging instruments are unchanged.

**Presentation and disclosures in financial statements**

The guidance note provides that derivative assets and liabilities recognised in a balance sheet at fair value should be presented as current and non-current and explains guidance on such presentation.

An entity is required to disclose its financial risks, methodologies used to arrive at the fair value of derivative contracts, extent of fair value gains/losses recognised in the financial statements, its risk management policies, etc. Further, specific disclosures are required for outstanding hedge accounting relationships.

**Transitional provisions**

The guidance note applies to all derivative contracts covered by it and are outstanding on 1 April 2016. Any cumulative impact (net of taxes) should be recognised in reserves as a transition adjustment and disclosed separately.

**Comparison with AS 30**

Compared to the earlier guidance under AS 30, hedge accounting is considerably easier to apply in many situations and in particular there is additional guidance on the following aspects:

- Synthetic accounting
- Fair value of derivatives – focus on exit price
- Situations where the hedged item is covered by an existing notified standard (AS 10, AS 13, and AS 11)
- The application of this guidance to non-foreign currency derivatives
- What constitutes a hedgable risk including aggregated and net exposures and components of non-financial items
- Which instruments can qualify as hedging instruments including improving the ability to hedge with options
- Removes bright line 80/125 per cent hedge effectiveness test requirements
- Allows for qualitative assessments in certain situations
- Clarifies that permissibility (e.g. Reserve Bank of India) of a product is not adequate to qualify for hedge accounting
- Permits basis adjustments for hedges relating to recognition of non-financial items
- Prohibits voluntary hedge de-designation if risk management objectives and hedging instruments are unchanged
- Presentation in the financial statements including guidance on current vs non-current designation.

(Source – KPMG’s First Notes dated 18 May 2015)
The ICAI issues a guidance note on accounting for expenditure on corporate social responsibility (CSR) activities

This article aims to:

- Provide an overview of the recently issued guidance note on accounting for expenditure on corporate social responsibility (CSR) activities by the Institute of Chartered Accountants of India (ICAI)
- Highlight the requirements of the Companies Act, 2013 and the Rules thereon vis-à-vis the guidance note.
Accounting of the CSR expenditure in the financial statements

Requirements under the 2013 Act and Rules

Rule 4 prescribes the manner in which a company should undertake CSR activities:

- **Rule 4(1)** – The CSR activities should be undertaken by the company, as per its stated CSR policy, as projects/programmes/activities (either new or ongoing), excluding activities undertaken in pursuance of its normal course of business.

- **Rule 4(2)** – The Board of a company may decide to undertake its CSR activities approved by the CSR Committee, through a registered trust or a registered society or a company established under Section 8 of the 2013 Act by the company either singly or along with its holding or subsidiary or associate company or along with any other company or holding or subsidiary or associate company of such other company, or otherwise:

  Provided that, if such trust, society or company is not established by the company either singly or along with its holding or subsidiary or associate company or along with any other company or holding or subsidiary or associate company of such other company, in the case of such projects or programmes to be undertaken through these entities, the modalities of utilisation of funds on such projects and programmes and the monitoring and reporting mechanism.

- **Rule 4(3)** – A company may also collaborate with other companies for undertaking projects or programmes or CSR activities in such a manner that the CSR committees of respective companies are in a position to report separately on such projects or programmes in accordance with these Rules.

Accounting treatment prescribed in the guidance note

The guidance note prescribes the accounting treatment for expenditure incurred on the CSR activities which is as follows:

- **Contribution to a fund specified in the Schedule VII** - In case a company contributes to a fund specified in the Schedule VII of the 2013 Act, the contribution would be treated as an expense for the year and charged to the statement of profit and loss.

- **Expenditure incurred by a company itself on the CSR activities** - In case a company incurs expenditure on any of the activities as per the Schedule VII of the 2013 Act, the company would need to analyse the nature of the expenditure keeping in view need to analyse the ‘Framework for Preparation and Presentation of Financial Statements’ (the framework) issued by the ICAI. If the company incurs which is revenue in nature, it should generally be charged as an expense for the year to the statement of profit and loss. In cases where expenditure may give rise to an ‘asset’, the company would need to assess whether it has control over the asset and is able to derive future economic benefits from it. In cases, where the control of the asset is transferred by the company, it should not be recognised as an ‘asset’ in its books and such expenditure should be charged to the statement of profit and loss. In other cases, where the company retains the control of the asset then it would need to be examined whether any future economic benefits accrue to the company. Invariably, future economic benefits from a ‘CSR asset’ would not flow to the company as any surplus from CSR cannot be included in business profits in view of Rule 6(2).

- **Expenditure through a trust, society, etc.** - Similarly, in case a company incurs expenditure on the CSR activities as per Rule 4(2), it should be treated as an expense for the year and charged to the statement of profit and loss.

- **Received grant from other companies for CSR activities** - In case a company receives a grant from others for carrying out CSR activities, the CSR expenditure should be measured net of the grant.

- **CSR activities by supplying goods manufactured by the company** - In case a company supplies goods manufactured by it or renders services as CSR activities, the expenditure incurred should be recognised when the control in the goods is transferred or the allowable services are rendered by the company. Accordingly, the goods manufactured would be accounted for as per principles of AS 2, *Valuation of Inventories* and services rendered should be measured at cost. The guidance note clarifies that all indirect taxes such as excise duty, service tax, VAT, etc. on such goods and services contributed would also form part of the CSR expenditure.

Recognition of income earned from CSR projects/programmes during the course of conduct of the CSR activities

Requirements under the 2013 Act and Rules

In respect of a CSR project/programme/activity undertaken by a company, it needs to be determined whether any surplus arises from it. Rule 6(2) requires that the surplus arising out of the CSR projects or programmes or activities would not form part of the business profit of a company.

Accounting treatment prescribed in the guidance note

The guidance note provides that a company needs to assess whether the surplus arising from the CSR activities can be considered as an ’income’. The framework defines ‘income’ as “increase in economic benefits during the accounting period in the form of inflows or enhancements of assets or decrease of liabilities that result in increase in equity, other than those relating to contributions from equity participants”. Since the surplus arising out of CSR activities does not arise from transactions with shareholders, accordingly, it meets the definition of ‘income’ for accounting purposes. Accordingly, surplus arising out of the CSR activities should be recognised in the statement of profit and loss. As per the guidance note, since such surplus does not arise out of ‘ordinary course of business’, it cannot be part of the business profits. Thus, the surplus should immediately be recognised as a liability for the CSR expenditure in the balance sheet and recognised as a charge to the statement of profit and loss.
Also, in order to compute the limit of two per cent of the average net profits criteria as per Section 135 of the 2013 Act, such surplus would not be included in the computation.

**Accounting for shortfall/excess spend and creation of provision in case of short spent**

**Requirements under the 2013 Act and Rules**

Section 135(5) of the 2013 Act provides that the board of every company covered under the CSR requirements should ensure that it spends, in every financial year, at least two per cent of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its CSR policy.

The proviso to this sub clause states that if such a company fails to spend such an amount, the board shall, in its report as per Section 134(3)(o) give details about the policy developed and implemented by the company on the CSR initiatives taken during the year and specify the reasons for not spending the amount.

Further, Rule 8(1) prescribes that the board’s report of a company under these Rules should include an annual report on CSR, containing particulars specified in the annexure to the said Rules, which provide a format in this regard.

**Accounting treatment prescribed in the guidance note**

As per the 2013 Act, expenditure on the CSR activities is required to be disclosed in the board’s report. The guidance note clearly states that in case there is a shortfall in spending on CSR activities below the prescribed threshold, no provision is required to be made for the shortfall. However, if the company has incurred a contractual liability then a provision should be created for the amount to be spent representing the extent to which the CSR activity was completed during the year in accordance with the generally accepted principles of accounting. The director’s report should disclose the reasons for not spending the prescribed amount as per the 2013 Act.

In case a company spends more than the prescribed threshold of two per cent on the CSR activities in a particular year, then such excess amount spent cannot be carried forward to subsequent years in the books of account for set off against the CSR expenditure required to be spent in the future.

**Presentation and disclosure in the financial statements**

**Requirements under the 2013 Act and Rules**

The Schedule III to the 2013 Act provides ‘General Instructions for Preparation of Statement of Profit and Loss’. Under these instructions, a company should disclose the amount of expenditure on the CSR activities by way of a note to the statement of profit and loss.

**Requirements of the guidance note**

- The guidance note recommends that expenditure on the CSR activities that qualify to be recognised as an expense should be presented as a separate line item as the ‘CSR expenditure’ in the statement of profit and loss. Further, the relevant note relating to the CSR expenditure should disclose break-up of various heads of expenses included in the line item ‘CSR expenditure’
- In case there is a contractual liability incurred for which a provision has been created in the balance sheet for the amount to be spent on the CSR activity. Such provision should be presented as per the Schedule III to the 2013 Act. Additionally, movements in the provision during the year should be shown separately
- The guidance note also recommends expenditure on the CSR activities should be disclosed by way of notes to accounts as follows:
  - Gross amount required to be spent by the company during the year
  - Amount spent during the year on:

<table>
<thead>
<tr>
<th>CSR activities</th>
<th>In cash</th>
<th>Yet to be paid in cash</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction/acquisition of any asset</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>On purposes other than (i) above</td>
<td></td>
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</tbody>
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- Disclosure to be made in the notes to the cash flow statement, (where applicable)
- Details of related party transactions, e.g. contribution to a trust controlled by the company in relation to the CSR expenditure as per AS 18, Related Party Disclosures.
The MCA amends the Companies Act, 2013

This article aims to:

Norms for related party transactions eased

Current requirements under 2013 Act and relevant Rules

Currently, Clause 49 of the Equity Listing Agreement issued by the Securities and Exchange Board of India provides that an audit committee may grant an omnibus approval for a related party transaction proposed to be entered into by the company, subject to certain conditions. Such omnibus approval would be valid for a period not exceeding one year and will require fresh approvals after the expiry of one year.

Amendment

Now, to align with the Equity Listing Agreement a proviso to Section 177(4)(iv) to the 2013 Act has been inserted to permit omnibus approval for proposed related party transactions subject to such conditions as would be prescribed.

Current requirements under 2013 Act and relevant Rules

Under Section 188 of the 2013 Act, a company is able to approve certain related party transactions through a special resolution.

Amendments

• Section 188 of the 2013 Act has been amended to provide that a company would now approve certain related party transactions through a resolution instead of a special resolution.

• Section 188 of the 2013 Act has been further amended to exempt related party transactions between a holding company and its wholly-owned subsidiary from the requirement of approval by non-related shareholders provided the accounts of the wholly-owned subsidiary is consolidated with the holding company and is placed before the shareholders at the general meeting for approval (similar to Clause 49 of the Equity Listing Agreement).

Threshold prescribed for reporting of frauds by the auditors

Current requirements under 2013 Act and relevant Rules

Under Section 143(12) of the 2013 Act, if an auditor of a company, in the course of the performance of his duties as an auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government within the prescribed time and in the prescribed manner as given in the relevant Rules.

In absence of any specific reporting threshold, the auditor was obligated to report insignificant amounts to the Central Government.

Amendment

Section 143(12) of the 2013 Act has now been amended to provide as follows:

• Reporting to the Central Government by auditors would be required only if the amount involved exceeds the threshold that would be prescribed

• In case of a fraud involving lesser than the specified amount, the auditor is required to report the matter to the audit committee (if constituted) or to the Board within such time and in such manner as may be prescribed

• The companies whose auditors have reported frauds to the audit committee or to the Board but the company has not reported to the Central Government, should disclose the details about such frauds in the Board’s report in such manner that would be prescribed.

Due to the above amendment, consequential amendment has been made in Section 134(3)(c) of the 2013 Act which deals with the Board’s report.

Definition of private/public company amended

Current requirements under 2013 Act and relevant Rules

• Section 2(68) and Section 2(71) of the 2013 Act, inter alia, requires a private company to have a minimum paid-up share capital of INR1 lakh and a public company is required to have a minimum paid-up share capital of INR5 lakh respectively.

Amendment

• Through the Amendment Act, 2015, the minimum paid-up share capital requirement for a private or a public company have now been omitted. Therefore, there is no minimum paid-up capital requirement any more.

Severe punishment prescribed for contravention of deposit acceptance norms

Current requirements under 2013 Act and relevant Rules

• No specific punishment was prescribed under the 2013 Act in case a company accepts deposits in contravention of provisions related to acceptance of deposits or where the company fails to repay the deposit/interest due within the due date.

Amendment

• This lacuna has now been corrected by inserting Section 76A in the 2013 Act which provides that:

  a. where a company accepts or invites or allows or causes any other person to accept or invite on its behalf any deposit in contravention of the manner or the conditions prescribed under Section 73 or Section 76 of the 2013 Act or Rules made thereunder or

  b. fails to repay the deposit or part thereof or any interest due thereon within the time specified under Section 73 or Section 76 of the 2013 Act or Rules made thereunder or such further time as may be allowed by the National Company Law Tribunal under Section 73 of the 2013 Act.

The consequences of the above non-compliances are as follows:

– the company would, in addition to the payment of the amount of deposit or part thereof and the interest due, be punishable with a fine which would not be less than INR1 crore but which may extend to INR10 crore, and

– every officer of the company who is in default would be punishable with imprisonment which may extend to 7 years or with a fine which should not be less than INR25 lakh but which may extend to INR2 crore, or with both.

Where it is proved that the officer of the company who is in default, has contravened such provisions knowingly or willfully with the intention to deceive the company or its shareholders or depositors or creditors or tax authorities, he would be liable for action under Section 447 of the 2013 Act which deals with punishment for fraud.
Strategic business decisions protected

Current requirements under 2013 Act and relevant Rules

As per Section 179(3) of the 2013 Act, Board of Directors are permitted to exercise certain powers by means of a resolution passed at Board meetings e.g. approval for borrowings, diversification of business, amalgamation, merger or reconstruction.

Under Section 117(3)(g) of the 2013 Act, resolutions passed above are required to be filed with the Registrar of Companies (RoC) within the prescribed time period.

Section 399 of the 2013 Act *inter alia* permits any person to inspect any documents by electronic means kept by the RoC in accordance with the prescribed Rules. Concerns were raised by corporate India as key decisions were being made publically available.

**Amendments**

- In order to protect strategic business decisions, Section 117(3)(g) of the 2013 Act has now been amended to provide that no person will be entitled under Section 399 to inspect or obtain copies of resolutions passed under Section 179(3) of the 2013 Act.
- Proviso to Rule 15 of the Companies (Registration Offices and Fees) Rules, 2014 has been inserted to provide that no person should be entitled to inspect or obtain copies of resolutions referred to in Section 117(3)(g) of the 2013 Act.

Amendments to rectify overreach by Rules over the 2013 Act

Current requirements under 2013 Act and relevant Rules

The Companies (Declaration and Payment of Dividend) Rules, 2014 (as amended) requires a company to set-off carried over previous losses and depreciation not provided in previous years against the profit of the current year, in order to declare dividend.

**Amendment**

The above requirement has now been included as a fourth proviso to Section 123(1) of the 2013 Act and consequently Rule (3)(5) of the Companies (Declaration and Payment of Dividend) Rules, 2014 has been omitted by the Amendment Act, 2015.

Current requirements under 2013 Act and relevant Rules

- Rule 10 of the Companies (Meetings of Board and its Powers) Rules, 2014 requires that the following transactions are exempted from the requirements of Section 185 of the 2013 Act provided that loans made are utilised by the subsidiary company for its principal business activities:
  - loan made by a holding company to its wholly-owned subsidiary company or any guarantee given or security provided by a holding company in respect of any loan made to its wholly-owned subsidiary company, and
  - guarantee given or security provided by a holding company in respect of loan made by any bank or financial institution to its subsidiary company.

Transfer of shares to Investor Education and Protection Fund

**Amendment**

Section 124(6) of the 2013 Act has been amended to rectify the requirement of transferring shares for which unclaimed/unpaid dividend has been transferred to the Investor Education and Protection Fund even though the dividend has been claimed.

Other amendments

- Currently, under Section 11 of the 2013 Act, a company having a share capital is not permitted to commence any business or exercise any borrowing powers unless:
  - a declaration has been filed by a director in such form and verified in such manner as may be prescribed, with the RoC that every subscriber to the memorandum has paid the value of the shares agreed to be taken by him/her and the paid-up share capital of the company is not less than INR5 lakh in case of a public company and not less than INR1 lakh in case of a private company on the date of making the declaration.
• Under Section 248(1)(b) of the 2013 Act, the RoC is required to send a notice to the company/directors of his intention to remove the name of the company from the register of companies if the subscribers to the memorandum have not paid the subscription which they had undertaken to pay and a declaration under Section 111(1) of the 2013 Act to this effect has not been filed within a period of 182 days from the date of incorporation of the company.

Through the Amendment Act, 2015, the above requirement has now been omitted. Therefore, going forward there will be no obligation on RoC to send the notice.

• The Amendment Act, 2015 has removed the requirement of having a common seal by companies by virtue of amendment in Section 9, Section 12(3)(b), Section 22(2) and (3), Section 46(1) of the 2013 Act and Section 223(4)(a) of the 2013 Act. The 2013 Act now provides that:
  - in case a company does not have a common seal, the authorisation under Section 22(2) (which deals with execution of bills of exchange) and Section 46(1) (which deals with certificate of shares) of the 2013 Act would be made by two directors or by a director and the company secretary (where appointed).

• Rule 5(3)(b) of the Companies (Incorporation) Rules, 2014 (relating to shares which are not in demat form) has been amended as follows:
  - Proviso to Rule 5(3)(b) has been amended to provide that in case a company does not have a common seal, the share certificate shall be signed by two directors or by a director and the company secretary, wherever, the company has appointed a company secretary.
  - Additionally, in case of one person company which does not have a common seal, it is provided that the share certificate should be signed by the persons in the presence of whom the seal is required to be affixed.

(Source – KPMG’s First Notes dated 2 June 2015)
Regulatory updates
Amendments to the SEBI (Issue of Capital and Disclosure Requirements) Regulations 2009 and SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011

The Securities and Exchange Board of India (SEBI) vide notification dated 5 May 2015 has issued the SEBI (Issue of Capital and Disclosure Requirements) (Second Amendment) Regulations, 2015. The amendment adds sub regulation (5) to Regulation 70 of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009. It is as follows:

• Conversion of debt into equity under strategic debt restructuring scheme:
   As per the amendment, the provisions relating to the ‘preferential issue’ are not applicable to:
   i. preferential issue of equity shares made to the consortium of banks and financial institutions pursuant to conversion of their debt as part of a strategic debt restructuring scheme, subject to the following conditions:
      a. conversion price should be determined in accordance with the guidelines specified by the Reserve Bank of India for strategic debt restructuring scheme, which should not be less than the face value of the equity shares
      b. conversion price should be certified by two independent qualifiedvaluers
      c. equity shares so allotted should be locked-in for a period of one year from the date of trading approval. However, for the purposes of transferring the control, the consortium of banks and financial institutions may transfer their shareholding to an entity before completion of the lock-in period subject to continuation of the lock-in on such shares for the remaining period with the transferee
      d. applicable provisions of the Companies Act, 2013 are complied with, including the requirement of special resolution
   ii. any other secured lender opting to join the strategic debt restructuring scheme in accordance with the guidelines specified by the Reserve Bank of India (RBI) and convert their debt into equity share in accordance with sub-regulation (5).

Consequential amendment has been made to the SEBI (Acquisition of Shares and Takeovers) Regulations, 2011. As per the amendment, acquisition of equity shares by the consortium banks, financial institutions and other secured lenders pursuant to conversion of their debt as part of the Strategic Debt Restructuring Scheme in accordance with the guidelines specified by the RBI. However, conditions specified under sub-regulation (5) or (6) of the regulation 70 of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009, as may be applicable, are complied with. The amendment has come into force from the date of their notification in the Official Gazette (i.e. 5 May 2015).


Meeting of the International Advisory Board of the Securities and Exchange Board of India (SEBI)

The SEBI vide press release dated 6 May 2015, has issued minutes of meetings held on 1 May 2015 and 2 May 2015 of its International Advisory Board (IAB), which, inter-alia, includes:

• Carving out a regulatory framework for market based financing of new age start-up sectors like technology, e-commerce, etc.

The IAB discussed the key proposals outlined in the SEBI consultation paper on carving out a regulatory framework for market based financing of new age start-ups in sectors like technology, e-commerce, etc. and made following observations:

i. A relevant necessary framework is essential to enable financing of start-ups given their potential in India
ii. Financing of start-ups is certainly a major challenge and the SEBI is proposing to address this challenge
iii. Given the high-risk high-return trade-offs involved in financing of start-ups and the regulatory concerns of ease of raising capital vs. investor protection, entry barriers to ensure participation of only sophisticated investors in the initial stage has been considered a good idea

iv. A need for a balanced regulatory approach towards valuation of start-ups has been felt as conventional valuation approach may not be applicable in the early stage of their operation. However, the need of adequate disclosures including suitable caution to investors about valuation cannot be overemphasised. The SEBI is expected to also evaluate if licensed sponsors could assist in strengthening the corporate governance of start-ups.

v. The SEBI may implement its proposed carve out regulatory framework for financing start-ups and make changes going forward based on the learnings along the way.

• Participation of institutional investors in the governance of investee company

It was observed that after SEBI mandated mutual funds in March 2013 to disclose specific rationale supporting their voting decision on quarterly basis the participation of mutual funds has increased from 48.5 per cent in FY 2013 to 83.1 per cent in FY2015 (till Dec 2014). The IAB recommended that the SEBI in coordination with other authorities may introduce a Code (on the lines of Stewardship Code of UK) based on the approach of ‘comply or explain’.

• Roadmap for regulating of commodity futures market

Based on the recent policy announcement of the Government of India to bring the regulation of commodity futures market under the jurisdiction of the SEBI, the IAB advised that the SEBI needs to conduct a thorough due diligence and gap analysis before articulating its vision for the commodity derivatives segment and should also concentrate more on studying the risks and the structure of the market, including various aspects like contract design,
Disclosures under the SEBI (Prohibition of Insider Trading) Regulations, 2015

With regard to the SEBI (Prohibition of Insider Trading) Regulations, 2015 issued on 15 January 2015, the SEBI has issued formats for disclosures. Such disclosures may be maintained by the company in physical/electronic mode.

The companies should also ensure the requirements of the regulation 8 (Code of Fair Disclosure) and regulation 9 (Code of Conduct):

- Formulated and published (on its official website), code of practices and procedures for fair disclosure of Unpublished Price Sensitive Information (UPSI) to be confirmed to the stock exchanges immediately
- Formulated code of conduct is confirmed to the stock exchanges immediately
- A company should deal with only such market intermediary/ever other person, who is required to handle UPSI and who has formulated a code of conduct as per the requirements of the Regulations.

The Stock exchanges have also been advised to:

- Put in place the adequate systems and issue the necessary guidelines for implementing the above decision
- Make necessary amendments to the relevant bye-laws, rules and regulations as applicable for the implementation of the above decision immediately
- Bring the provisions of this circular to the notice of the listed companies/ issuers and also to disseminate the same on the website immediately.

Ready forward contracts in corporate debt securities

The Reserve Bank of India (RBI), vide circular dated 26 February 2014 issued a framework for revitalising distressed assets in the economy - refinancing of project loans, sale of NPA and other regulatory measures (the framework).

According to the framework, banks could reverse the excess provision on the sale of non-performing assets (NPA) if the sale is for a value higher than the net book value (NBV) to its statement of profit and loss in the year the amounts are received. Further, as an incentive for early sale of NPAs, banks could spread over any shortfall, if the sale value is lower than the NBV over a period of two years. This facility of spreading over the shortfall was however available for NPAs sold up to 31 March 2015 and was subject to necessary disclosures in the notes to account in annual financial statements of the banks.

However the RBI, vide notification dated 21 May 2015 has extended this dispensation for assets sold on or after 31 March 2015 and up to 31 March 2016.


The Institute of Chartered Accountants of India (ICAI), vide announcement dated 8 May 2015, has highlighted the relevant extracts from the report of Standing Committee on Finance (2014-15) regarding the National Financial Reporting Authority (NFRA) and National Advisory Committee on Accounting Standards (NACAS).

Section 132 of the Companies Act, 2013 (2013 Act) provides for constitution of NFRA to provide for matters relating to accounting and auditing standards under the 2013 Act. However this Section of the 2013 Act is yet to be notified for commencement. Until this Section is notified, similar functions are to be carried out by the NACAS under Section 210A of the Companies Act, 1956.

Further, Section 132(4) of the 2013 Act specifically provides that notwithstanding anything contained in any other law for the time being in force, the NFRA should have the power to investigate, either suo motu or on a reference made to it by the Central Government, for such class of bodies corporate or persons, in such manner as may be prescribed into the matters of professional or other misconduct committed by any member or firm of chartered accountants, registered under the Chartered Accountants Act, 1949.

In view of the provisions of above mentioned Section, it has been concluded by the committee that there would be no overlap in the functions of the NFRA and the ICAI.
The MCA issues relaxations for private companies from certain provisions of the Companies Act, 2013

On 24 June 2014, the Ministry of Corporate Affairs (MCA) vide Section 462(1) of the Companies Act, 2013 (2013 Act) issued a draft notification proposing a number of modifications with respect to certain Sections of the 2013 Act that would be applicable to a private company.

The comment period ended on 1 July 2014.

After nearly one year, on 5 June 2015 the MCA issued a final notification which provides exceptions/modifications/adaptations to some of the provisions of the 2013 Act for private companies. These notifications would come into force from the date of their publication in the Official Gazette.

For a detailed overview of the key exceptions/modifications/adaptations made to the 2013 Act for private companies, please refer to KPMG’s First Notes dated 11 June 2015.

(Source - Notification by the MCA dated 5 June 2015)
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KPMG in India is pleased to re-launch IFRS Institute - a web-based platform, which seeks to act as a wide-ranging site for information and updates on IFRS implementation in India. The website provides information and resources to help board and audit committee members, executives, management, stakeholders and government representatives gain insight and access to thought leadership publications that are based on the evolving global financial reporting framework.

The MCA issues relaxations for private companies from certain provisions of the Companies Act, 2013

On 24 June 2014, the Ministry of Corporate Affairs (MCA) vide Section 462(1) of the Companies Act, 2013 (2013 Act) issued a draft notification proposing a number of modifications with respect to certain Sections of the 2013 Act that would be applicable to a private company.

The comment period ended on 1 July 2014.

After nearly one year, on 5 June 2015 the MCA issued a final notification which provides exceptions/modifications/adaptations to some of the provisions of the 2013 Act for private companies. These notifications would come into force from the date of their publication in the Official Gazette.

Our issue of the First Notes provides an overview of the key exceptions/modifications/adaptations made to the 2013 Act for private companies.

On 18 June 2015, on the call, we covered the salient features of Indian Accounting Standard (Ind AS) 103, Business Combinations along with key differences from AS 14, Accounting for Amalgamations. We explained the transitional provisions related to Ind AS 103 that are included in Ind AS 101, First-time Adoption of Indian Accounting Standards.

On the call, we also provided an overview of the key amendments introduced by the Companies (Amendment) Act, 2015 and Rules thereon.

The IASB issues a formal proposal to defer the effective date of the new revenue standard

On 19 May 2015, the International Accounting Standards Board (IASB) published an exposure draft (ED) of proposed amendments to IFRS 15, Revenue from Contracts with Customers to change the effective date of IFRS 15. It proposes that IFRS 15 would apply for annual reporting periods beginning on or after 1 January 2018. Earlier application would continue to be permitted. Entities would also continue to be permitted to choose between applying the standard either retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying the standard recognised at the date of initial application.

The IASB and FASB Joint Transition Resource Group have discussed a number of application issues. In light of those issues, the IASB has tentatively decided to propose amendments to IFRS 15 which are expected to clarify, instead of change, the requirements of the standard. These amendments are expected to be included in an ED which is slated to be published later in 2015.

Feedback on the ED is required by 3 July 2015.

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The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

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