

Year-end considerations

Updates of standards, interpretations and regulatory considerations affecting your financial statements





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Foreword

Companies reporting under Indian Accounting Standards (Ind AS) continued to face steady flow of new accounting standards and regulatory changes in the financial year 2019-20. These changes range from significant amendments of fundamental accounting principles, enhanced disclosure requirements to some minor updates arising from the changes in International Financial Reporting Standards (IFRS).

Some of these changes go beyond the matters of accounting and reporting. They potentially impact the internal controls and information systems of the companies and their business decisions, such as buying versus leasing decisions.

With regulatory environment becoming more stringent, stakeholders' expectations from companies and auditors are increasing. Stakeholders now demand enhanced level of transparency and disclosures. Consequently, there is a need for companies to proactively understand the changes, assess their impact on financial statements and prepare their systems and processes to ensure smooth transition to new accounting standards and regulatory changes.

As we come close to the end of the financial year, we have summarized the key changes and their impact to assist companies in ensuring compliance with these developments while finalizing their annual financial statements.

Purpose of this publication

This publication provides an overview of the upcoming changes in accounting and auditing standards and interpretations as well as regulatory changes. It does not attempt to provide an in-depth analysis or discussion on the changes. Rather, it aims to highlight key aspects of these changes. Reference should be made to the text of the pronouncements before taking any decisions or actions.

This publication consists of three sections:

Section 1 provides an overview of the key accounting changes as at 30 January 2020 and certain key amendments that are applicable for financial statements ending 31 March 2020 and beyond.

Section 2 summarizes the auditing pronouncements issued as at 30 January 2020 and the Companies (Auditor's Report) Order, 2020 notified by the Ministry of Corporate Affairs (MCA) in February 2020.

Section 3 provides a glance at the regulatory and other changes that have been issued. There have been a significant number of regulatory updates during this year which have consequential impact on accounting and disclosures. These amendments also pave the way for aligning with some of the best practices followed globally and bring in a renewed focus on improved corporate governance by way of better structure, more rigorous checks and balances, and greater independence of all key gate-keepers, including the Board of Directors and auditors.



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Section 1:

New accounting pronouncements relevant for financial statements of FY 2019-20 or thereafter



During the financial year 2019-20, there have been certain amendments in the existing Indian Accounting Standards (Ind AS). Various groups and committees of the Institute of Chartered Accountants of India (ICAI) have rolled out additional guidance through Educational Material and clarifications provided by Ind AS Technical Facilitation Group (ITFG). Six ITFGs (ITFG Clarification Bulletin No.18-23) were issued during the financial year. The following section covers a summary of the key changes and the potential impact that these changes may have on the financial statements of companies. We have summarized the changes topic wise to provide a comprehensive view for the companies to apply them and the impact these changes may have on their financial statements.

Overview of amendments to Ind AS

1. Leases

1.1: Educational Material on Ind AS 116

On 30 March 2019, the Ministry of Corporate Affairs (MCA) notified Indian Accounting Standard (Ind AS) 116, the new leases accounting standard. Ind AS 116 is applicable for the financial year beginning from 1 April 2019 for all Ind AS companies. It replaces the existing guidance under Ind AS 17 Leases. Consequential amendments were made to certain other standards as well.

For lessee, the new standard presents a single lease model, which is a significant change from the dual model approach currently followed in Ind AS 17. The applicability of Ind AS 116 will lead to increase in leased asset (i.e., right to use assets) and financial liabilities on the balance sheet of the lessee. This will

result in a more faithful representation of lessees' assets and liabilities and provide greater transparency of lessees' financial obligations and leasing activities. The lessor accounting remains largely unchanged from Ind AS 17 except in case of straight lining of lease income which is irrespective of whether the escalation is in line with general inflation.

The Institute of Chartered Accountants of India (ICAI) has also issued "Educational Material on Ind AS 116" clarifying some of the important aspects of the implementation. In this section, we have discussed a few key clarifications which are likely to have a significant impact on the companies.

Key clarifications in Educational Material on Ind AS 116

1. What is the lease term in case of cancellable leases?

Clarification

As per Ind AS 116, a lease is no longer enforceable when both the lessee and lessor have the right to terminate the lease without the permission from the other party with no more than an insignificant penalty. In case, where the lease cannot be terminated without incurring no more than insignificant penalty, it becomes enforceable and, in such case, lessee will have to estimate the lease term.

Further, the educational material clarifies that in determining the enforceable period of the lease, companies should consider the broader economics of the contract and not only the contractual termination payments while identifying insignificant penalty. If either party has an economic incentive not to terminate the lease such that it would incur a penalty on termination that is more

than insignificant, the contract is enforceable beyond the date on which the contract can be terminated.

2. How does a lessee determine the discounting rate to be used for calculating the present value of the lease payments and for measuring the lease liability?

Clarification

Ind AS 116 states that lessees shall measure the lease liability on initial measurement by discounting the lease payments using the interest rate implicit in the lease and if that rate is not readily determinable, the lessee should use its incremental borrowing rate.

The educational Material clarified that the interest rate implicit in the lease is likely to be equivalent to the lessee's incremental borrowing rate as both take into account the credit standing of the lessee, the length of the lease, the nature and quality of the collateral provided and the economic environment in which the transaction occurs.

However, the interest rate implicit in the lease is generally also affected by a lessor's estimate of the residual value of the underlying asset at the end of the lease term and initial direct costs of the lessor. In such cases, the interest rate implicit is not necessarily the rate stated in the contract and in the absence of relevant information, the lessee may not be in a position to readily determine it. If interest rate implicit in the lease is not readily determinable by the lessee, the standard requires the lessee to use its incremental borrowing rate to discount the lease payments.



Adoption of the new standard does not comprise of accounting compliance alone. It affects a wider gamut of things, including financial ratios, processes, controls, judgements, disclosures, etc. It is important for the companies to identify the necessary changes to policies and enterprise resource planning (ERP) systems to ensure that lease transactions are appropriately evaluated through the lens of the new requirements.

Dr. Devesh Prakash

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3. What is the accounting treatment for interest free refundable security deposit (SD) paid/payable in tranches for assets taken on leases?

Clarification

Ind AS 116 is silent on the treatment of security deposits paid as part of the lease arrangements. However, the educational material has clarified that refundable security deposit given by a company is a financial asset as per Ind AS 109 and hence, where the effect of time value of money is material, it should

be discounted and presented at its present value on initial recognition (i.e., at the time of commencement of lease). In terms of the rate at which it should be discounted, the company needs to evaluate the rate to be considered for discounting keeping in mind the guidance as per Ind AS 109. Further, since the interest free security deposit is paid to a lessor in respect of a non-cancellable lease arrangement, the difference between the present value of deposit and the amount of deposit should be considered as a prepaid lease rental and included in right-of-use (ROU) asset.

If the security deposit is payable in tranches, the company will recognize on initial recognition (i.e., at commencement of lease) the present value of the total amount at fair value as per Ind AS 109 and the difference between the transaction amount and present value as calculated above, will be recognized as part of the ROU asset which will be depreciated over the lease term. For deposit which is payable in tranches in future, company will have to recognize a corresponding other liability.

4. Whether Goods and Services Tax (GST) paid by lessee to lessor is considered as part of consideration in the contract?

Clarification

GST is a consumption-based tax which is the liability of the lessee towards the government. Although the same is paid by the lessee to the lessor, it cannot be considered as a lease payment since it is paid to the government and the lessor merely acts as a collection agent. Therefore, GST, whether or not refundable, would not be included in the measurement of the lease liability or right-of-use asset.

5. Whether property tax paid by lessee is considered as a lease payment as per Ind AS 116?

Clarification

The property tax paid represents the amount payable by the lessee for activities and costs that do not transfer goods or services. Accordingly, such considerations are considered a part of the total consideration that is allocated to the identified lease and non-lease components.

6. What is the accounting treatment for initial direct costs (IDC) in case of a lease modification?

Clarification

In absence of a specific guidance in Ind AS 116, the educational material clarified that companies might consider drawing analogy to accounting of IDC at commencement and apply similar accounting on the modification date. IDC on lease modification are included in measurement of new ROU asset (if modification is accounted as a separate lease) or the adjustment to ROU asset (for modification that is not accounted as separate contract).

7. What is the accounting in the books of lessor for operating lease income, where escalations are in line with general inflation index?

Clarification

The lessor shall recognize lease income on a straight-line basis even though the escalations are in line with general inflation index.

Impact

There has been a complete overhaul of the lease accounting which now brings a more substantive approach that facilitates easy comparability, improves quality of financial reporting, and brings more

transparency to the user of the financial statements, the financial metrics and financial indicators.

Adoption of the new standard does not comprise of accounting compliance alone. It affects a wider gamut of things, including financial ratios, processes, controls, judgements, disclosures, etc. The companies need to identify necessary changes to policies and system to ensure that lease transactions are appropriately evaluated through the lens of the new requirements. Following are some insights which companies may need to consider while ensuring effective compliance with the requirements:

- 1) Impact of clarifications in the educational Material for computation of lease liability and right-of-use assets

As mentioned above, the Educational Material has clarified certain aspects for practical implementation of Ind AS 116. Companies will have to evaluate whether their existing computations and assumptions are in line with the clarifications provided therein and also evaluate implications of the same on other aspects like:

- ▶ Evaluation of the lease terms in case of leases with termination options

- ▶ Aligning the lease term used for discounting of security deposits with that of the lease term used for computation under Ind AS 116

- ▶ Accounting for initial direct costs, property taxes and GST in line with the clarifications provided

- 2) Practical considerations for selecting transition options

Based on the experience of the listed companies that have already transitioned to Ind AS 116 for their quarterly reporting, following are the some of the practical considerations which companies may consider while evaluating impact of the transition option:

Transition options	Full retrospective approach	Modified retrospective approach: option A	Modified retrospective approach: option B
Approach	Ind AS 116 to be applied for each period presented in financial statements. Lease liability and ROU asset is calculated as if the standard had been applied since the inception of all lease contracts that are presented in the financial statements.	Lease liability is calculated as the present value of remaining lease payment discounted using the incremental borrowing rate (IBR) on date of transition. ROU asset is calculated as a carrying amount, as if standard had been applied since the commencement of lease contracts, discounted using Incremental Borrowing Rate (IBR) on date of transition.	Lease liability is calculated as the present value of remaining lease payment discounted using incremental borrowing rate (IBR) on date of transition. ROU is equal to lease liability adjusted with prepaid rent and lease liability recognized in balance sheet immediately before the date of transition.
Data requirements			
Extensive data collection	Details of lease contract to compute ROU shall be required from the lease commencement date to transition date including, but not limited to, all modifications thereof	Details of lease contract to compute ROU shall be required since lease commencement date to transition date including, but not limited to, all modification thereof Some practical expedients available for this transition approach like initial direct cost exclusion, hindsight in determination of lease term, etc.	Details of lease contract to compute ROU shall be required from transition date onwards. Some practical expedients available for this transition approach like initial direct cost exclusion, hindsight in determination of lease term, etc.

Transition options	Full retrospective approach	Modified retrospective approach: option A	Modified retrospective approach: option B
Non-availability of data	Lease contract details such as discount rate, initial direct cost, discounted dismantling cost, etc. may not be available on commencement of each lease.	Reduced efforts as compared to full retrospective approach as discount rate need not to be determined as on commencement but on transition date.	Reduced efforts as compared to all other transition options being prospective in nature
Quantification considerations			
Complexity of quantification	The process has become more complex as modification to leases will require remeasurement of the lease liability on each modification.	The process has become less complex as compared to full retrospective approach, as lease payments as adjusted by modifications are required, there is no need to remeasure the lease liability on each modification.	Being prospective in nature, historic details on modification and consequential adjustments are not required.
Other considerations			
Impact on net worth	The difference between ROU asset and lease liabilities along with adjustment of rent equalization reserve shall have impact on the net worth.		This transition approach would be neutral for net worth as ROU and lease liability would be the same.
*Impact on future Profit Before Tax (PBT)	Future charge to P&L will be lesser as compared to the modified Option B approach.	Generally, future charge to P&L will be lesser as compared to modified Option B approach.	Generally, future charge to P&L will be higher as compared to other transition options.
Impact on Earnings Before Interest Depreciation and Amortization (EBITDA)	Improved EBITDA on account of savings in rental expenses. However, it will be neutral of the transition option selected.		
Restatement of previous year	Requires restatement of previous years, i.e., FY 18-19.	Restatement of previous year is not required.	Restatement of previous year is not required.

It is to be noted that the impact on future PBT is subject to other factors such as ageing of lease portfolio, additional leases added, discount rate, etc.

3) Key Presentation and Disclosure requirements that Companies need to be mindful about

a) Presentation of the lease liability

Whether the lease liability is to be disclosed as part of borrowings or other financial liability or separately as lease liability on the face of the balance sheet, disclosure will be driven in India by Schedule III of the Companies Act, 2013. Currently, there is no clarification regarding the same from the MCA and hence companies are following varied practices.

In the absence of clarification, companies are making accounting policy choice regarding the presentation and ensuring to evaluate the impact of the same on debt covenants, if included in borrowings, and also on the calculation of financial ratios involving debt.

However, ICAI, has proposed following amendments in Schedule III to align the same with Ind AS 116. These include:

- In the format of a balance sheet, a separate line item to be added as Lease liabilities under the sub-head Financial

liabilities (under both current and non-current liabilities).

- Also, from the existing format line items, Long term maturities of finance lease obligations under non-current liabilities and Current maturities of finance lease obligations under current liabilities to be deleted.

The above amendments have not been notified yet.

See Annexure I to this publication for illustrative Ind AS 116 disclosures.

b) Financial ratios

Companies with material off-balance sheet lease commitments may have significant changes in their key financial metrics such as leverage ratio, Return on Capital Employed (ROCE), EBITDA, operating cash flows and valuation multiples. These changes may lead to implications for loan covenants as well. Companies may also have to consider the impact to financial indicators as required by the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 notification dated 9 May 2018 and consequential disclosure requirements in the annual report.

c) Disclosure requirements

Ind AS 116 adds significant new, enhanced disclosure requirements for both lessors and lessees. Some of these include:

▶ Significant assumptions and judgements made

The new lease standard will continue to require significant judgements and estimates. However, many of these judgments and estimates may receive scrutiny because of the impact of financial statement and additional disclosures. Key judgements and estimates are as follows:

- ▶ Identification of lease
- ▶ Identification of non-lease component of lease
- ▶ Lease term assessment considering termination and renewal options
- ▶ Discount rate
- ▶ Maturity analysis of lease liabilities (for lessees) or lease receivables (for lessors),

separately by lease type, as of the reporting date, including a reconciliation of undiscounted cash flows to the lease liabilities or receivables

- ▶ New disclosures for lessee include the following:
 - ▶ Separate quantitative disclosure of lease cost, by type (e.g., low value lease, short-term lease, variable lease)
 - ▶ Weighted-average remaining lease term, separately by lease type
 - ▶ Weighted-average discount rate, separately by lease type

4) Internal financial controls

The management of the companies may need to establish governance, policies and standards for identifying and resolving data gaps and implementing processes to verify the quality of information needed for implementation of the new standard. Robust internal control mechanisms are likely to ensure utmost quality, compliance and completeness of the financial statements, including quantitative and qualitative disclosures.

Companies will need to determine ways to address the risks, which might include following:

i. Identification of leases in a contract

Significant judgements may be required in identifying leases under the new standard. The company should be able demonstrate proper documented policies and technical memos depicting the relevant facts, management estimates and judgements.

ii. Data collection

Significant efforts are required for data collection relating to

different lease arrangements as well as for extracting information from each lease contract. Processes and controls may need to be revised to ensure the organization has access to the data required for accounting and reporting requirements, both at the time of inception of a lease and over the lease term.

Companies should develop a process and controls to determine the incremental borrowing rate for each type of leases that they broadly enter into. For e.g., car leases could have a separate incremental borrowing rate as compared to a property lease.

Also, companies may consider creating a broad range for the lease term to determine the incremental borrowing rate for that particular term. For e.g., a range of one to three years, three to six years, 6-10 years and more than 10 years as separate categories for determining incremental borrowing rates may be determined.

iii. Quantification

Companies may need to consider application controls over data processing (e.g., the calculations of the lease liability and ROU asset). Complexities may be further increase if companies have frequent modification to lease contracts.

iv. Reconciliation

Company should also establish an additional process to prepare reconciliation between actual lease payments during the period against the charge in profit and loss on account of depreciation and interest as cross check for accuracy and comprehensiveness.



Application of Ind AS 116 may require installation of new IT systems to handle data relating to leases for computation of lease accounting and for the purpose of disclosures to ensure smooth transition to Ind AS 116.

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5) System changes

There is a likelihood for companies to have transitioned to Ind AS 116 and quantified the impacts of the new lease standard using MS Excel. However, going forward, the application of Ind AS 116 may require installation of a new IT system to handle the data to account for and disclose information on leases. Existing systems may require upgrades and even addition of new functionalities or reports in order to enable the companies to comply with the standards requirements. This will be critical for companies having a large portfolio of leases and for companies, which have several modifications in their agreed terms and conditions of a lease contract during the lease term. In such cases, to keep control of all the modifications and compute their impacts on the ROU asset and lease liability will become increasingly cumbersome.

Companies may evaluate various lease accounting systems available in market such as ERP based solutions like Contract and Lease Management (CLM) module of Systems, SAP, Oracle Lease Management or stand-alone accounting engines like EY Lease Accounting Navigator which are likely to enable them in end-to-end lease management, compliance, analytics and real-time reporting.

1.2: Key clarifications issued by ITFG on Ind AS 116

Issue 1

Application of short-term lease exemption where the agreements have been renewed in the past as a common business practice

Summary of guidance

Ind AS 116 defines short-term lease as a lease which has a lease term of 12 months or less at the commencement date and does not include purchase option.

Lease period has been defined to include non-cancellable period coupled with renewal option which lessee is certain to exercise and period covered by termination option which lessee is reasonably certain not to exercise.

Determination of lease term takes into account the period for which lease agreement is enforceable. If the agreement does not convey a right of renewal to lessee, an enforceable contract does not exist beyond the period covered by the lease agreement. Accordingly, a lessee should not consider the past practice of renewal while determining lease term for a contract if right of renewal is not covered by lease agreement.

Basis above, if the period of lease agreement does not exceed 12 months and the agreement does not convey right of renewal to lessee, lessee can avail short-term lease exemption for

such agreements even if there is history of renewal upon expiry in past.

Impact

There was a confusion if the past practice of agreement renewals should be considered while determining lease term even if the right of renewal does not emanate from the agreement. This issue was highly prevalent in case of related party arrangements. The issue has been put to rest by this clarification.

Issue 2

Determination of lease term where a contract provides cancellation rights to both lessee and lessor and lessee is reasonably certain not to exercise cancellation option.

Facts of the case

Lessee is engaged in the business of power generation and transmission. The lessee has entered into a lease arrangement with a government-owned entity for an overhead line facility across the railway track for contract term of 10 years for the right of way. The lessee expects to continue its business beyond the existing contract term. Either party shall have the liberty to put an end to the arrangement by giving one-month notice in writing to that effect without any compensation being payable by lessor. In case lessor gives the notice, lessee shall, at its own cost, remove under the supervision of lessor the transmission line and shall restore the land to its original condition to the satisfaction of the lessor in all respects.

Summary of the guidance

At the commencement date, while assessing whether the lessee is reasonably certain to exercise an option to extend or purchase the underlying asset, or not to exercise an option to terminate the lease, the entity considers all relevant facts and circumstances. This includes importance of the asset to lessee's operations, costs associated with termination of the lease as well

as significant leasehold improvements incurred or expected to be incurred, that create an economic incentive for the lessee to exercise, or not to exercise, the option, including any expected changes in facts and circumstances from the commencement date until the exercise date of the option.

In the given case, lessee should consider following for making assessment if it is reasonably certain to not exercise the termination option:

1. Its intention to continue business
2. Availability of alternate lands
3. Costs associated with termination (costs of setting up alternate lines)

Lessor's right to terminate the lease at any time, appears, prima facie, is meant to be exercised only in exceptional circumstances. At lease commencement, there seems no economic incentive for lessor to terminate the lease prematurely. In case, another entity approaches lessor for the right of way, it seems that it can provide the right of way at some distance from location of transmission line of lessee, without terminating existing arrangement with lessee.

Based on its detailed and in-depth knowledge of the facts and circumstances of the case, if lessee concludes that it is reasonably certain at lease commencement that the termination option would not be exercised, the lease term would be 10 years, and, consequently, the lease will not qualify as a 'short term lease'.

Impact

Existing provisions of Ind AS 116 state that when each party is entitled to unilaterally terminate the lease without incurring more than an insignificant penalty, the option to extend the contract should not be considered unless there is an enforceable contract to that effect.

ITFG clarified that penalties should be interpreted broadly to include economic disincentives and mere existence of

mutual termination options does not mean that the contract is automatically unenforceable at a point in time when a potential termination could take effect.

Issue 3

Treatment of rent equalization reserve on initial application of Ind AS 116

Summary of guidance

The treatment of lease equalization reserve as at the date of transition to Ind AS 116 will depend on the transition method chosen by a company. The following are the ones available under the standard:

- 1) Full retrospective approach: companies can choose to apply Ind AS 116 retrospectively by applying Ind AS 8.
- 2) Modified retrospective approach: a lessee recognizes a lease liability measured at the present value of the remaining lease payments and discounted by using the lessee's incremental borrowing rate at the date of initial application. A lessee measures the right-of-use asset on a lease-by-lease basis, either at:
 - a. its carrying amount as if Ind AS 116 had always been applied since the commencement date, but using a discount rate based on the lessee's incremental borrowing rate at the date of initial application
 - b. an amount equal to the lease liability, adjusted for previously recognized prepaid or accrued lease payments

In case of full retrospective approach (as per 1 above) and modified retrospective approach (as per 2(a) above), any difference between lease liability and right of use asset so recognized and lease equalization reserve as on the date of transition will be recognized in equity, as appropriate.

In case of modified retrospective approach (as per 2(b) above), lease

equalization reserve will be treated as accrued lease liability and adjusted with ROU asset arising on initial application date, thereby having no impact on the equity as on the date of transition.

Impact

Prior to the clarification being issued, it was not clear how should an entity treat amount appearing as lease equalization reserve. ITFG has clarified that rent equalization reserve amount is analogous to accrued lease liability and should be dealt accordingly.

Issue 4

Can a lessor continue to recognize lease rentals on a basis other than straight lining if lease payments are structured to increase in line with expected general inflation to compensate for the lessor's expected inflationary cost increases.

Summary of guidance

Ind AS 17 stated that a lessor shall recognize lease income from operating leases in income on straight-line basis over lease term except, inter alia, when the lease payments to the lessor are structured to increase in line with expected general inflation to compensate for the lessor's increase in expected inflationary cost.

Whereas Ind AS 116 states that a lessor shall recognize lease payments from operating leases as income on either a straight-line basis or another systematic basis. The lessor shall apply another systematic basis if that basis is more representative of the pattern in which the benefit from the use of the underlying asset is diminished.

It is pertinent to note that Ind AS 116 does not allow exception to straight-lining requirements when lease payments are structured to increase in line with expected general inflation to compensate for the lessor's expected inflationary cost increases. Accordingly, a lessor under an operating lease is mandatorily required to recognize lease income on straight-line basis over lease

term except when some other basis is more representative of the pattern in which benefit from the use of the underlying asset is diminished.

The resultant change in manner of recognition of operating lease rentals by lessor will represent a change in an accounting policy which will need to be accounted for as per Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors, in the absence of specific transitional provisions in Ind AS 116 dealing with the change.

Impact

Lessor companies which were not recognizing rental income on straight-line basis under Ind AS 17 where lease rentals were structured to increase in line with expected general inflation to compensate for the lessor's expected inflationary cost increases, will now have to mandatorily recognize the rental income on straight-line basis.

2. Income Taxes

2.1: Amendment to Ind AS 12: Appendix C to Ind AS 12

Key requirements

The MCA amended Ind AS 12 on Income Taxes to include Appendix C on Uncertainty over Income Tax Treatments (corresponding to IFRIC 23) on 30 March 2018, which came into effect from 1 April 2019. Changes explain ways to recognize and measure deferred and current income tax assets and liabilities where there is uncertainty over a tax treatment.

The appendix is applicable to taxes within the scope of Ind AS 12 and applies to both current and deferred taxes.

Scope

Companies may have various transactions and circumstances where they may be unclear how the applicable tax law would apply. In such cases, the acceptability may not be known until the relevant taxation authority or a court takes a decision in the future. A dispute on examination of a particular tax treatment by the taxation authority may impact the accounting for current or deferred tax asset or liability.

A tax treatment for which there is uncertainty over whether the relevant taxation authority's acceptance under tax law is called an uncertain tax treatment.

Prior to introduction of this appendix, there was no guidance under any Ind AS in respect of accounting for uncertain tax treatments.

This appendix defines tax treatments as used by a company or as plans that a company may use in its income tax filings. Further, it defines taxation authority as the body or a group of bodies that decide whether tax treatments are acceptable under tax law and also includes a court. It is key to note that this appendix restricts its purview to only income taxes. Hence, all levies, charges and indirect taxes are outside the scope of this appendix.

Unit of account

Each uncertain tax treatment is considered separately or together as a group, depending on the approach that better predicts the resolution of the uncertainty. While determining the best approach, companies might consider the following factors, among others:

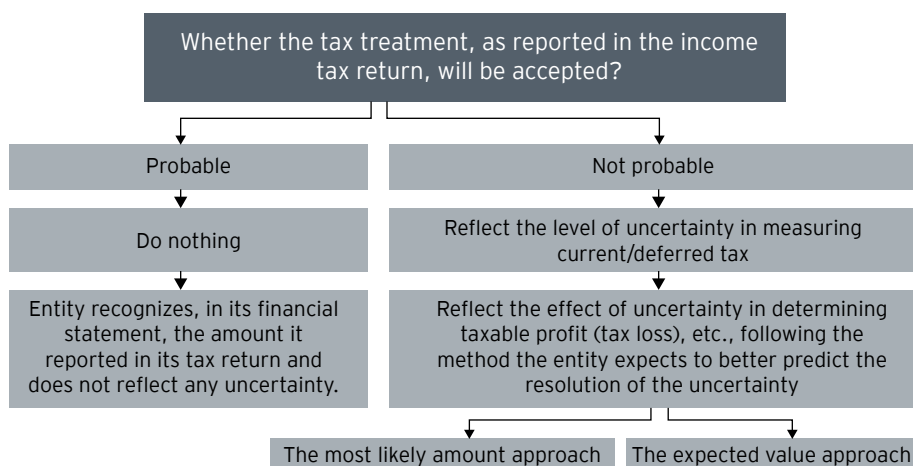
- ▶ How the company prepares its income tax filings and supports tax treatments
- ▶ The approach company expects the taxation authority to take during its examination and resolve issues that might arise during the examination
- ▶ The extent to which the outcomes of uncertain tax treatments are mutually dependent
- ▶ The resolution of similar tax issues by taxation authorities in prior years

The appendix does not specifically scope in or scope out interest and penalties from its ambit. Instead the appendix applies to 'Income taxes' within the ambit of Ind AS 12

Assumptions about the examination of tax treatments by taxation authorities

Companies are required to assume that a tax authority with the right to examine and challenge tax treatments will examine those treatments and have full knowledge of the related information.

Flowchart for determination of treatment for uncertain tax treatments



Source: EY analysis

Accounting for any uncertain tax treatments

Determination of tax treatments when it is probable

Once a company concludes that it is probable for the taxation authority to accept an uncertain tax treatment, it shall measure all applicable taxes consistently with its income tax filings. No adjustment in respect of this Appendix shall be made in this case. The term probable is defined in IFRS as more likely than not.

The measurement requirements in this appendix do not distinguish between a probability of 51% and a probability of 100%. This is consistent with the objective of Ind AS 12 that also refers to a probable threshold.

In determining, whether the tax position is probable to be accepted by tax authority, companies may consider the following:

- ▶ Past experience related to similar tax treatments
- ▶ Legal advice or case law related to other companies
- ▶ Practice guidelines published by the taxation authorities that are applicable for the specific case
- ▶ A pre-clearance obtained from the taxation authority on an uncertain tax treatment

Companies shall need to maintain appropriate and robust documentation to support its position pertaining to the probability of tax treatments.

Determination of tax treatments when it is not probable

If a company concludes that it is not probable that the treatment will be accepted by taxation authority, it should reflect the same in its income tax accounting in the period in which that determination is made (for e.g., by recognizing an additional tax liability or applying a higher tax rate). The company is required to reflect such uncertainty for each uncertain tax treatment by using either of the following methods, depending upon which method the company expects to better predict the resolution of the uncertainty:

The most likely amount is:

- ▶ the single most likely amount in a range of possible outcomes
- ▶ used when the possible outcomes are binary or are concentrated on one value

Example

Company B incurs INR500 in a series of costs to repair equipment. The entire amount is expensed in the current period for financial reporting purposes. The company reports a deduction of INR500 in calculating taxable profit in its income tax filing. It has a tax rate of 25%.

The tax law permits the repairs to be deducted for income tax purposes; however, there is uncertainty about whether the costs are deductible in the year incurred or over a 10-year period.

Company B assesses and concludes that it is probable that the tax authority would require the tax deductions to be deducted over 10 years.

Company B has already made its tax return after considering INR500 as deduction (hence INR125 as tax benefit) and hence the tax provision as per return does not reflect the uncertainty. Hence, the company is required to record additional current tax expense of INR112.50 ($\text{INR450} \times 25\%$). However, since the deduction is allowable in future periods, a deferred tax asset of the same amount should be recorded.

The result is that Company B's financial statements reflect the following based on the most likely deduction:

- ▶ current tax benefit of INR12.50: $\text{INR50 deduction} \times \text{tax rate of } 25\%$; and
- ▶ deferred tax benefit of INR112.50: $\text{future deduction of INR450} \times \text{tax rate of } 25\%$.

The expected value

- ▶ is the sum of the probability-weighted amounts in a range of possible outcomes
- ▶ is used when possible outcomes are neither binary nor concentrated on one value

Example

Company X's income tax filing includes a deduction (single tax treatment) of INR1,500 related to intercompany services that only affect taxable profit for the current period. The company has a tax rate of 25%. It concludes that it is not probable that the tax treatment as filed on its income tax return will be accepted, but that it is more likely than not to realize some benefit for the position based on its technical merits.



Company X analyzes the potential outcomes:

Outcome	Possible deduction	Amount disallowed	Probability of position	Expected value disallowed
1	1500	-	25%	-
2	1000	500	30%	150
3	700	800	25%	200
4	300	1200	10%	120
5	-	1500	10%	150
			100%	620

All values in the above table are in INR.

Company X concludes that the expected value disallowed to be INR620. Consequently, the company increases its current tax expense by INR155 (INR620 X 25%).

Changes in facts and circumstances

Companies are required to reassess judgements about the acceptability of tax treatments, its estimates of the effect of uncertainty if the facts and circumstances change or when there is a new information that affects those judgements. Such change shall be prospectively accounted for, as a change in accounting estimate as per Ind AS 8 on Accounting Policies, and Changes in Accounting Estimates and Errors.

The following are some examples of changes that can result in reassessment of judgements or estimates previously made by the company:

- ▶ The results of examinations or actions taken by a taxation authority such as:
 - ▶ Agreement or disagreement by the taxation authority with the tax treatment or a similar tax treatment used by the company.
 - ▶ Information that the taxation authority has agreed or disagreed with a similar tax treatment used by another company.
 - ▶ Information about the amount received or paid to settle a similar tax treatment.
- ▶ Changes in rules established by the taxation authority.
- ▶ The expiry of a taxation authority's right to examine or re-examine a tax treatment.

Disclosures

There are no new disclosure requirements in Appendix C to Ind AS 12. However, the application guidance to the appendix refers to requirements of Ind AS 1 on Presentation of Financial Statements. Hence, under this appendix, a company shall determine where the following should be disclosed:

- a) Judgements made in determining taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates applying paragraph

122 of Ind AS 1, Presentation of Financial Statements, i.e., it shall determine whether to disclose any judgements that the management has made in the process of applying the appendix and that have the most significant effect on the amounts recognized in the financial statements

- b) Information about the assumptions and estimates made in determining taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates applying paragraphs 125-129 of Ind AS 1.

Transition requirement

Companies can, on initial application, elect to apply this appendix either:

1. Retrospectively applying Ind AS 8, if possible without the use of hindsight

Or

2. Retrospectively, with the cumulative effect of initially applying the Appendix recognized at the date of initial application as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate). If company selects this transition approach, it shall not restate comparative information.

Impact

The appendix is based on IFRIC 23 under IFRS and now aligns Ind AS with principles laid down in US GAAP - FIN 48 as well. However, it has been noticed that due to the implementation of FIN 48 and IFRIC 23, companies, especially large multinational groups, had to adopt structured processes and procedures for gathering information and documenting the judgments applied in recognition and measurement of uncertain tax treatments and disclosure of information that is helpful to users of the financial statements. Some of the key implementation challenges or impact areas are:

1. Identification of uncertain tax position

Companies need to set-up robust systems and processes to identify uncertain tax treatment. Identification of uncertain tax treatments involves significant estimate and judgement. In assessing whether uncertainty over income tax treatments exists, companies may consider a number of indicators including, but not limited to, the following:

- Ambiguity in the drafting of relevant tax laws and related guidelines (such as ordinances, circulars and letters) and their interpretations.
- Income tax practices that are generally applied by the taxation authorities in specific jurisdictions and situations.
- Results of past examinations by taxation authorities on related issues.
- Rulings and decisions from courts or other relevant authorities in addressing matters with a similar fact pattern.
- Tax memoranda prepared by qualified in-house or external tax advisors.
- The quality of available documentation to support an income tax treatment.

Companies may need to do a comprehensive review of all the tax positions irrespective of whether these positions have been disclosed as contingent liabilities in the financial statements or not.

The appendix does not specifically scope in or scope out interest and penalties from its ambit. The basis of conclusions which are part of IFRIC 23 provides that if a company considers a particular amount payable or receivable for interest and penalties to be an income tax, then the amount is



The new guidance on Uncertainty over Tax Treatments changes the way companies compute their provisions for taxation. The appendix is based on IFRIC 23 and now aligns Ind AS with the principles laid down in US GAAP - FIN 48 as well.

Jigar Parikh

Partner, Financial Accounting Advisory Services (FAAS), EY India

within the scope of Ind AS 12 and this appendix. Conversely, if a company does not apply Ind AS 12 to a particular amount payable or receivable, then this appendix does not apply. The current interpretation of whether the interest and penalties are considered to be within the scope of Ind AS 12 is an important consideration. Managements' current assessment with respect to interest and penalties would continue for this appendix also.

2. 100% detection risk

The appendix requires companies to assume a detection risk of 100%. Companies should not take any credit for the possibility that uncertain tax treatments could be overlooked by the taxation authority. This is a different approach compared to the existing practice that may lead to changes when interpretation is first applied.



Companies may need to do a comprehensive review of all the tax positions, irrespective of whether they have been disclosed as contingent liabilities in the financial statements or not. The government has announced Vivaad Se Vishwas Scheme where companies can opt for settlement of tax litigation. Companies should also consider the probabilities of the settlement while measuring uncertain tax positions.

Ayush Agrawal

Director, Financial Accounting Advisory Services (FAAS), EY India

The interpretation does not explain what is meant by “results of examinations”. The examination procedures vary by jurisdiction. In some jurisdictions, an examination can have multiple phases. In our view, the communication between company and the taxation authorities, during the course of such examinations, may provide relevant information that could give rise to a change in facts and circumstances before the actual results are formally issued. Since this is a different approach compared to existing practice, it may lead to significant impacts on transition. Companies who were making provision only for assessment

years for which demand notices were received from the authorities, need to revisit their policy. They need to provide for all the year for which such uncertain tax position exists irrespective of whether demand notices have been received or not.

3. Application of significant estimate and judgement

Companies may need to apply significant judgement in selecting the method that better predict the resolution of an uncertainty. Although companies might apply a particular method to all similar uncertain tax treatments, assessing each situation separately is essential to ensure that the method adopted better reflects the resolution of the uncertainty. In our view, applying a measurement method to reflect uncertainties is not an accounting policy choice; rather the selection should be made on a case-to-case basis based on which approach better predicts the resolution of the uncertainty.

The outcome of an uncertain tax treatment will often be binary. For example, a deduction might be allowed or rejected in full. In such circumstances, measurement using the single most likely amount might be more appropriate. However, when a number of interdependent uncertainties are considered together, or when a single uncertain tax treatment can be partially accepted by the taxation authorities, the expected value approach is likely to better predict the resolution of the uncertainty. Companies need to exercise judgement, based on their knowledge of how the relevant taxation authority operates and using professional advice, where required.

Further, in our view, companies should assess the impact of uncertainties on current and deferred taxes separately. Companies should not consider the effect of uncertainties for

recognition and disclosure purposes just because the net impact in many cases could be zero.

The government has announced Vivaad Se Vishwas Scheme where companies can opt for settlement of tax litigation. Companies should also consider the probabilities of such settlement of litigation while measuring uncertain tax positions.

4. Development of robust systems and processes to manage uncertain tax positions

As FY 19-20 is first year of implementation, companies need to bring together a cross-functional team to build an appropriate response. The following are the key steps that companies can take in this regard:

- ▶ Companies must include the requirements and guidance provided in the interpretation in the group accounting manual. The accounting manual should include clear and robust guidelines related to the application of the probable threshold, judgements, estimates, requirements regarding consultation with internal tax advisors and involvement of external advisors.
- ▶ The guidelines must, where possible, also include a standardized template for the technical analysis, risk assessment and measurement.
- ▶ Companies must implement robust controls around review and sign-off procedures. For example, significant judgements that affect the group as a whole might require a sign off by the group head of taxation.
- ▶ Companies must establish a process to gather and communicate the latest information, such as decisions by the court on issues similar to those they are facing internally on a timely basis.

- ▶ Companies must implement a process for identifying and assessing uncertainty over income tax treatments that is consistent across the group. For example, companies in a group should neither be too aggressive nor too conservative when assessing or identifying uncertain tax treatments.

2.2: Amendment to Ind AS 12 Income Taxes

Key requirements

The income tax consequences of dividend shall be recognized in the statement of profit or loss, other comprehensive income or equity according to where the past transactions or events that generated distributable profits were recognized.

Impact

It is necessary to link dividend to originating transactions or events that generated the distributable profits giving rise to dividend, to determine where the income tax consequences of dividend should be recognized. For example, Dividend distribution tax (DDT) pertaining to a preference share which was classified as liability, should also be recognized in P&L since the dividend for the same would also have been recognized in the same statement. Similarly, DDT paid/payable on dividend declared on equity shares (including instruments classified as equity as per Ind AS 32) should be recognized in statement of changes in equity.

2.3: Key clarification issued by ITFG

Issue 1

Accounting for deferred tax adjustments relating to items recognized in equity/ other comprehensive income (OCI) on transition to Ind AS or initial application of an Ind AS

Summary of guidance

As per provisions of Ind AS 12, an entity is required to account for the tax consequences of transactions and other events in the same way that it records the transactions and other events themselves. Thus, for transactions and other events recognized in profit or loss, any related tax effects are also considered in profit or loss. For transactions and other events recognized outside profit or loss (either in other comprehensive income or directly in equity), any related tax effects are also considered outside profit or loss (either in other comprehensive income or directly in equity, respectively).

This raises the issue on the accounting of the changes in amounts arising from remeasurement of deferred tax assets or deferred tax liabilities at lower tax rates introduced by the Taxation Laws (Amendment) Ordinance, 2019 (Ordinance). Whether such changes should be recognized directly in equity in respect of deferred tax assets or deferred tax liabilities which were recognized by corresponding adjustment to equity at the time of first-time adoption of Ind ASs or at the time of initial application of Ind AS 115 and Revenue from Contracts with Customers, or Ind AS 116, Leases, to the extent still unrealized/ not settled.

It is important to note that adjustments to equity in respect of deferred tax assets or liabilities in the aforesaid circumstances do not necessarily mean that the items to which these deferred taxes relate to were recognized "directly in equity" as per the term used in paragraphs 58 and 61A of Ind AS 12. The transaction or event in paragraphs 7 and 58(a) of Ind AS 12, refers to the source which gave rise to the deferred tax implication. Consequently, directly in equity in paragraphs 58(a) and 61A(b), relate to the base transaction/ event. In other words, the deferred tax accounting follows the accounting of the source transactions/ events.

An entity should determine the nature of the underlying items with respect to which deferred taxes it had recognized at the time of first-time adoption of Ind ASs or at the time of initial application of Ind AS 115 or Ind AS 116. For example, for Ind AS adjustments made on first-time adoption of Ind AS, the items on which the original deferred tax arose needs to be determined (using the entity's current accounting policies), these items would have been recognized if Ind AS had been applied to them in the earlier periods. Accordingly, depending on the nature of an item, the change in the amount of the related deferred tax asset or deferred tax liability resulting from the remeasurement of the same at lower tax rates introduced by the Ordinance should be recognized in profit or loss, other comprehensive income or directly in equity as required by paragraphs 58 and 61A of Ind AS 12.

Impact

There were two views regarding subsequent deferred tax adjustments accounting relating to items which are recognized in equity/OCI on first-time adoption of Ind AS or initial application of an Ind AS.

Some believed that the considering requirement given in para 58 and 61A of Ind AS 12, any subsequent change in deferred tax (e.g., resulting from tax ordinance of 2019) should be recognized directly in equity/OCI as original impact of first-time adoption/ initial application.

Now ITFG has clarified that the words directly in equity in paragraphs 58(a) and 61A(b), relate to the base transactions/events and not cover those transactions/events whose impact is adjusted in equity/OCI due to first time adoption/initial application of an Ind AS. Considering this clarification, companies may need to evaluate any positions taken earlier.

3. Employee Benefits

3.1: Amendment to Ind AS 19 Employee Benefits

Key requirements

When a defined benefit plan's amendment, curtailment or settlement occurs, a company shall remeasure the net defined benefit liability/asset using the current fair value of the plan's assets and current actuarial assumptions, including current market interest rates and prices, reflecting the benefits offered under the plan and the plan's assets both before and after its amendment, curtailment or settlement.

Further, the company has to measure the current service cost to be recognized in P&L using the actuarial assumptions determined at the start of the annual reporting period till the plan was amended, curtailed or settled and using the revised actuarial assumptions for the remainder of the annual reporting period.

Similarly, the net interest on the defined benefit liability is determined by using the net defined benefit liability/asset and discount rates determined at the start of the annual reporting period till the plan was amended, curtailed or settled and using the remeasured net defined benefit liability and the discount rate is used to remeasure it for the remainder of the annual reporting period.

The above calculations will not include the effects of the asset ceiling. The same shall be calculated separately and recognized in other comprehensive income.

The company shall apply these amendments occurring on or after the beginning of the first annual reporting period that begins on or after 1 April 2019.

Impact

Prior to this amendment, Ind AS 19 required the company to remeasure its net defined benefit liability or asset when an amendment to, or a curtailment or settlement of a defined benefit plan took place. However, it was not explicit on how to determine the expenses incurred after the change to defined benefit plan has taken place. Companies should ensure that actuary is provided with necessary data.

Based on this amendment, if a plan's amendment, curtailment or settlement occurs, it is now mandatory that the current service cost and net interest for the period after the remeasurement are determined using the assumptions used for the re-measurements.

4. Borrowing Costs

4.1: Amendment to Ind AS 23 Borrowing Costs

Key requirements

As per the amendment in Ind AS 23, while computing the capitalization rate for funds borrowed generally, a company should exclude borrowing costs made specifically for obtaining a qualifying asset, unless the asset is ready for its intended use or sale.

Borrowing costs that remain outstanding even after the related qualifying asset is ready for intended use or for sale would subsequently be considered as part of the general borrowing costs of the company. This means that, specific borrowings would be treated as general borrowing once the related qualifying asset is ready for intended use or for sale. The standard also clarifies that a company shall include funds borrowed specifically to obtain an asset other than a qualifying asset as part of general borrowings.

The company shall apply these amendments prospectively for borrowing costs incurred on or after the beginning of the first annual reporting period that begins on or after 1 April 2019.

Impact

When a qualifying asset for which specific borrowing is taken is ready for its intended use or sale, if the specific borrowing taken for the same is still outstanding, it shall be considered as part of general borrowing for determination of the capitalization rate for the ongoing capitalization which is not yet ready for its intended use or sale.

Therefore, the companies who have expensed out any borrowing cost on specific borrowings related to qualifying asset, and such borrowings are outstanding on or after 1 April 2019 and the asset that they relate to is ready for its intended use or sale, will now have to be capitalized the same as part of fund borrowed generally for obtaining qualifying asset. This may impact the capitalization rate for general borrowings.

4.2: Key clarification issued by ITFG

Issue 1

Determination of expenditure incurred on qualifying assets acquired in business combination for the purpose of capitalization of borrowing costs in standalone and consolidated financial statements.

Summary of guidance

In a business combination, the consideration has been discharged in cash and acquirer has also acquired capital work-in-progress (CWIP) which meets the definition of qualifying assets under Ind AS 23. Carrying value of such CWIP in the books of acquiree entity is INR1,00,000 while the value determined as per purchase price allocation towards CWIP is INR1,20,000.

This ITFG clarification addresses the accounting for borrowing costs on such qualifying assets as under:

Consolidated financial statements of acquirer

For purposes of consolidated financial statements, the determination of whether an asset meets the definition of a qualifying asset and the amount of expenditure incurred thereon is made from the perspective of the group rather than from the particular member of the group which owns or holds the said asset. For this purpose, the amount allocated as part of purchase price allocation is considered as expenditure incurred on acquiring the said qualifying assets, i.e., INR120,000 and not INR100,000 in this example, assuming the CWIP meets the definition of qualifying assets from the group's perspective. Further, the timing of incurrence of such expenditure on the asset would also have to be determined from the group's perspective rather than from the perspective of acquiree.

Standalone financial statements of the acquirer

The standalone financial statements of the acquirer would include the investment made by the acquirer in acquiree (rather than individual assets and liabilities of acquiree). As this investment is a financial asset, borrowing costs cannot be capitalized since Ind AS 23 categorically states that financial assets are not qualifying assets.

However, if the acquirer acquires an unrelated, independent entity for cash consideration and merges it into itself, the timing of incurrence of the aforesaid expenditure on qualifying assets is to be determined from the perspective of acquirer and not from the perspective of acquiree. The amount allocated as part of purchase price allocation is considered as expenditure incurred on acquiring the said qualifying assets. Accordingly, the CWIP would appear as an asset in the standalone (and consequently, in the consolidated) financial statements of acquirer at INR120,000 and not INR100,000 in this example.

Impact

Though this clarificatory bulletin does not bring any new requirement, it reiterates some of the important aspects of consolidated financial statements and borrowing costs which we believe preparers of financial statements will find useful in discharging their reporting responsibilities.

However, it is not clear whether ITFG has considered situations where fair value of net assets acquired is more than the consideration paid (i.e., bargain purchase scenarios).

5. Business Combinations, Consolidation and Investment in Joint Venture and Associate

5.1: Amendment in Ind AS 103 – Business Combinations

Key requirements

When a party to a joint arrangement (as defined in Ind AS 111, Joint Arrangements) obtains control of a business, that is a joint operation, it is to be considered as a business combination achieved in stages.

Accordingly, the acquirer should re-measure its previously held interest in the joint operation at fair value.

This amendment is applicable to business combinations whose acquisition date is on or after the beginning of the first annual reporting period i.e., 1 April 2019.

Impact

Erstwhile Ind AS 111 was silent on accounting in case a party in joint operation obtains control of a business leading to diversity in practice. The amendment clarified that the acquirer should re-measure its previously held interest in the joint operation at fair value. It is essential for the company to ensure that when it acquires control of a business where it was erstwhile a joint operator, it shall re-measure its previously held interest. This may impact the book profit and accordingly Minimum Alternate Tax (MAT) calculation, if the company is covered under MAT.

5.2: Amendment in Ind AS 111 Joint Arrangements

Key requirements

If a party that participates in but does not have joint control of a business, obtains a joint control, it should not re-measure its previously held interest in the joint operation.

A company shall apply these amendments to transactions in which it obtains joint control on or after the beginning of the first annual reporting period beginning on or after 1 April 2019.

Impact

In contrast to clarification of Ind AS 103, the company shall ensure that when it acquires joint control of a business that is operated jointly, it shall not remeasure its previously held interest.



5.3: Amendment in Ind AS 28 – Investments in Associates and Joint Venture

Key requirements

In case of accounting for long-term interests in associates or joint venture, which in substance forms part of the net investment in associate or joint venture, but to which equity accounting is not applied, such as preference shares and long-term receivables or loans for which the settlement is neither planned nor is likely to occur in the foreseeable future, companies shall account for such interests under Ind AS 109, before applying Para 38, i.e., the loss allocation and Para 40-43, i.e., impairment requirements) under Ind AS 28.

The amendment also includes an example that illustrates how companies should apply the requirements in Ind AS 109 and Ind AS 28 to long-term interests in an associate or joint venture.

Applicability of the above amendments:

- ▶ The amendment is to be applied retrospectively in accordance with Ind AS 8 for annual reporting periods beginning on or after 1 April 2019.
- ▶ If a company applies the above amendments at the same time it applies Ind AS 109, it shall apply the transition requirements in Ind AS 109.
- ▶ If a company applies the above amendments after it applies Ind AS 109, it shall apply the transition requirements set out in Ind AS 109 for the accounting of long-term interests discussed above and it is not required to restate the prior periods to reflect the application of amendments unless it is possible to restate the prior periods without the use of hindsight.
- ▶ If a company does not restate the prior periods at the date of initial application of the amendments, it shall recognize in the opening retained earnings as any difference

between the previous carrying amount of the long-term interests and the carrying amount determined as per the amendments.

Impact

Ind AS 109 excludes interest in associates and joint ventures accounted or in accordance with Ind AS 28 from its scope. There was uncertainty in practice about whether Ind AS 109 applies to a company's long-term interest in an associate and joint venture to which the equity method does not apply but forms a part of the company's net investment in the investee (long-term interest). The amendment clarified that the exclusion in Ind AS 109 applies only to interests accounted using the equity method.

Also, there was a lack of clarity whether impairment of long-term interests should be governed by Ind AS 109, Ind AS 28 or both. The amendment includes an example that clarifies the measurement requirement. The measurement requirements for long-term interests in joint venture/associate which are not equity accounted can be summarized as follows:



Step 1: First apply requirements of Ind AS 109 (such as loss allowance and fair value changes) to measure the long-term interests which are not equity accounted

Step 2: Adjust the prior year's Ind AS 28's loss allocations to the above amount either by re-allocating them between different long-term interests or reversing the losses

Step 3: Allocate any current year's Ind AS 28 losses to the extent that there is any remaining long-term interest balance in order of their superiority (i.e., priority in liquidation)

The amendment may affect companies that finance its associates and joint ventures with preference shares or loans for which the repayment is not expected in foreseeable future. Such companies will have to evaluate the impact of the above on the long-term interests recognized in their financials currently and apply the appropriate transition requirements to comply with this amendment.

5.4: Key clarification issued by ITFG

Issue 1

Preparation of a balance sheet as at the beginning of preceding period in case of common control business combination

Summary of guidance

A merger between two entities which meets the criteria of common control business combination, is a change in composition of the reporting entity. The same shall not be seen as retrospective restatement or retrospective reclassification as mentioned in para 10 of Ind AS 1.

Further, para 9 of Appendix C of Ind AS 103 requires restatement of financial information of prior periods as if the business combination had occurred from the beginning of the preceding period in the financial statements, irrespective of the actual date of the combination unless it occurred later than beginning of the preceding period where financial information is restated only from that date.

Appendix C of Ind AS 103 does not require presentation of a third balance sheet at the beginning of the preceding period.

Accordingly, in case of merger between two entities, if it meets the definition of a common control business combination, a balance sheet as at the beginning of preceding period is not required to be presented (unless the beginning of the preceding period also happens to be the date of transition to Ind ASs in a particular case).

Impact

This clarification deals with requirement to prepare a balance sheet at the beginning of preceding period in case of common control business combinations. It clarifies that restatement of financial information as a result of common control business combination should not be treated as retrospective application of an accounting policy, retrospective restatement or retrospective reclassification as required under Ind AS 1.

Issue 2

Accounting for common control business combination in the books of transferor and transferee

Summary of guidance

Two entities under common control, filed a scheme of arrangement with NCLT in 2017. Pursuant to the scheme, one of the business divisions of the transferor entity was to be carved out and merged with the transferee entity. The scheme was approved by the NCLT in June 2019, i.e., before the approval (by the Board of Directors) of the financial statements for the year ended 31 March 2019. The appointed date of merger as per the scheme is 1 April 2018. Both entities, prepared their first Ind AS financial statements for year ended 31 March 2018 as follows:

Accounting treatment in the books of transferee:

Ind AS 103 requires restatement of comparative financial information from the beginning of preceding period in case of common control business combination unless the business combination occurred after that date.

Accordingly, financial information need to be restated from the beginning of the comparative period presented in the financial statements for the year ended 31 March 2019, i.e., 1 April 2017, notwithstanding the appointed date of 1 April 2018 specified in the scheme.

Accounting treatment in the books of transferor:

Appendix C to Ind AS 103 lays down accounting for a common control business combination only from the perspective of the transferee. Consequently, its requirement for restatement of comparative information

also applies only to the transferee and not the transferor. However, transferor needs to consider whether any disclosures are required to be made by it pursuant to the requirements of Ind AS 105, Non-current Assets held for Sale and Discontinued Operations.

Impact

Ind AS does not specifically deal with accounting in case of a common control business combination in the books of transferor and accordingly, ITFG's clarification, in this case, is important. It was clarified that transferor needs to account for the transaction from the date it loses control and need not coincide with the transferee. This will result in profit of transferred business reflected two times. For instance, in the example mentioned above, profit for the period 1 April 2017 to June 2019 (assuming accounting treatment in the scheme states that business will be derecognized in the books of transferor company on the date when the court's order becomes effective) will be reflected in the books of both transferor and transferee. This may result in double tax if both the transferor and transferee are covered in MAT.

Issue 3

1. Is an investor required to change accounting policies adopted by an associate when applying equity method if its policies are in accordance with local laws of the associate?
2. Whether change referred in Ind AS 28 also applies to accounting estimate (such as useful lives, depreciation method, etc.)?

Summary of guidance

Ind AS 28 requires that an entity's financial statements shall be prepared using uniform accounting policies for transactions and events that are in similar circumstances except in case of an associate, it is impracticable to do so. In case of any differences, changes need to be made to financial statements of associate to ensure conformity of accounting policies.

The financial statements so drawn are special-purpose financial statements, meant for the limited purpose of application of equity method by the investor and should not be seen as a breach or non-compliance of the local laws applicable to the associate.

Under Ind AS 16, depreciation method and useful life is a matter of an accounting estimate, and not an accounting policy. However, in drawing up the financial statements of the associate as per Ind ASs, the requirements of Ind AS 16 need to be considered in determining an appropriate depreciation method and useful life for each item of property, plant and equipment (or significant part). The resultant method and useful life for an item of property, plant and equipment (or significant part) may be different from the method applied by the associate in preparing and presenting its financial statements to comply with its local laws.

Impact

ITFG has clarified that even when financial statements of an associate have been drawn in accordance with local laws, it is required to be restated for the purpose of applying the equity method under Ind AS 28.

Though clarification does not deal with accounting policy differences in case of subsidiaries and joint ventures, discussions are relevant even in those scenarios.

Issue 4

Accounting for consideration received by investor (in form of equity shares) pursuant to transfer of one or more businesses between two fellow associates.

Summary of the guidance

Background/facts

Associate companies (A Ltd and B Ltd) of X Ltd undertook a transaction whereby one division (representing one or more businesses) of associate company (A Ltd) got demerged and vested in B Ltd. Consideration for the transaction was discharged by issue of fresh shares of B Ltd to shareholders of A Ltd, including X Ltd.

X Ltd has opted to account for its investments in associates at cost in the separate financial statements.

The two principal issues to be determined in the present case are: what amount should be derecognized and what amount should be recognized, by X Limited to give accounting effect to transfer of business undertaking from A Ltd to B Ltd.

Prior to the demerger, X Ltd.'s investment in A Ltd represents its interest in both the demerged business undertaking as well as other businesses of A Ltd whereas post-demerger, X Ltd.'s investment in A Ltd only represents its interest in businesses retained by A Ltd. Thus, to the extent of reduction of its interest in A Ltd, the shares of B Ltd received by X Ltd under the demerger scheme have an implicit cost associated with them. Neither Ind AS 27 nor any other standard under Ind ASs deals specifically with the issue as to how the amount to be derecognized should be determined in the kind of situation under discussion.

However, considering guidance available in Ind AS 8 for selection of accounting policies for transactions where Ind ASs do not provide specific guidance, analogy may be drawn from Ind AS 103 and Ind AS 115. Ind AS 103 requires that in case of asset acquisitions, not constituting a business, the cost of the acquirer shall be allocated to the individual identifiable assets and liabilities on the basis of their relative fair values at the date of purchase. Similar guidance is available in Ind AS 115 which requires the use of relative stand-alone selling prices in allocating the transaction price to each performance obligation.

Accordingly, the carrying amount of X Ltd.'s investment in A Ltd may be split between the demerged business undertaking and businesses retained by A Ltd on the basis of the relative fair values of the two, with the portion of carrying amount allocated to the former being derecognized.

Ind AS 27 does not define what is meant by cost except in the specific circumstances of certain types of group reorganizations (which differ from the nature of the transaction under discussion).

In the present case, however, there is no exchange of investments. X Ltd continues to hold the same number and proportion of equity shares in A Ltd after the demerger as it did before the demerger. Accordingly, in the given facts of the case, it would be an appropriate view to take that the cost of the additional shares is represented by the amount derecognized by X Ltd in respect of its investment in A Ltd while accounting for the demerger.

Impact

ITFG clarification provides an important clarification in an area where Ind ASs do not contain elaborative guidance. In case of group reorganizations,

where a transaction has no commercial substance, shareholders may allocate the cost of existing investment to the shares of the transferee company.

However, considering peculiar facts of the case, the guidance should not be applied by analogy to other issues.

6. Financial Instruments

6.1: Amendments in Ind AS 109 – Financial Instruments

Key requirements

There are certain types of debt instruments/loans where the borrower has the right to prepay the instrument at an amount that could be less than the outstanding principal and interest. Such a prepayment feature is often referred to as including potential negative compensation.

Under the existing requirements of Ind AS 109, a company would have measured such debt instrument at Fair Value through Profit and Loss Account (FVTPL) since the negative compensation feature would have been considered as cash flows that were not solely payment of principal or interest.

However, based on the amendment to the standard, the pre-payable financial assets with negative compensation can be measured at amortized cost. To qualify for amortized cost measurement, the negative compensation must be a reasonable compensation for an early termination of the contract and the asset must satisfy the business model of held to collect.

The company shall apply these amendments retrospectively in accordance with Ind AS 8 on or after the beginning of the first annual reporting period that begins on or after 1 April 2019. Additional transitional requirements and corresponding disclosure requirements must be observed when applying amendments for the first time.

Impact

The amendment brings relief for companies with financial assets with these prepayment features as they will now be able to measure such instruments at amortized cost if the negative compensation is a reasonable compensation for an early termination of the contract and the asset satisfies the business model of held to collect. Companies with such instruments will have to evaluate the transitional requirements for reclassification from FVTPL to amortized cost and give appropriate disclosures.

6.2: Key clarification issued by ITFG

Issue 1

Accounting for waiver of interest on loan repayable on demand

Facts of the case

Entity A, which prepares its financial statements as per Ind ASs, obtained a loan from one of its directors during 2015-16 and is outstanding as at the end of 2018-19. The loan is not related to a qualifying asset and is repayable on demand. In respect of interest on the loan for 2018-19, a waiver was obtained from the director without amendment of the loan agreement.

(It is assumed that that the director is not a shareholder and is not compensated through remuneration for the interest waived)

Summary of the guidance

Entity A is contractually required to pay interest on the loan it obtained from a director but the same is waived off by the director. To achieve fair presentation, it is appropriate that Entity A recognizes its contractual obligation for payment of interest as well as the waiver thereof by recognizing the interest as an expense and the waiver thereof as an item of income. The matter may also require disclosure as part of related party disclosures.

Impact

Clarification provides useful guidance for accounting waiver of interest without modification to terms of financial instrument. ITFG has clarified that interest expense and waiver thereof should be recognized as separate components in financial statements to achieve a fair and faithful presentation and should not be offset/not recognized at all.

However, it is pertinent to note that in case of waiver of interest from shareholders in the capacity as shareholders or where waiver is compensated by way of remuneration, accounting treatment will be governed by substance of the transaction and may be accounted as equity contribution/reduction of remuneration, as applicable rather than being recognized as a component of income.

6.3: ICAI's Expert Advisory Opinion on financial instruments

EAC 1 - Treatment of guarantee fees paid in computation of effective interest rate on borrowings

Treatment of guarantee fees paid in computation of effective interest rate on borrowings applies to a company that is required to pay an initial guarantee fee in respect of a loan taken, whether the same should be considered while computing the effective interest rate of the loan in case where the guarantee provided is a pre-condition for obtaining and continuing the loan as per the terms and the guarantee is not cancellable during the tenure of the loan. There is no specific guidance on whether for the purpose of calculating the effective interest rate considers only cash flows arising under the loan agreement towards interest and fee payable to the lenders, or the guarantee fee payable should not be included since it is not payable to the lenders, but to the guarantor.

Key requirements

As per Ind AS 109, in applying the effective interest method, a company identifies the fee that are an integral part of the effective interest rate of a financial instrument. This fee includes origination fees received by the company relating to the creation or acquisition of a financial asset, commitment fees received by the company to originate a loan and origination fees paid on issuing financial liabilities measured at amortized cost. The fee is treated as an adjustment to the effective interest rate, unless the financial instrument is measured at a fair value with the change in fair value being recognized in profit or loss.

Transaction costs include fees and commission paid to agents (including employees acting as selling agents), advisers, brokers and dealers, levies by regulatory agencies and security exchanges, and transfer taxes and duties.

The EAC noted that transaction costs are incremental costs that are directly attributable to the acquisition or issue of a financial liability and an incremental cost is the one that would not have been incurred if the company had not acquired or issued the financial instrument. In this context, the EAC has taken a view that the guarantee fee paid (initially as well as subsequently) is an incremental cost which is directly attributable to the acquisition of the loan facility as it would not have been incurred if the company had not incurred the loan liability.

Accordingly, the EAC opined that the financial guarantee fee paid (initially as well as subsequently) should be considered for computation of effective interest rate while measuring the loan liability at amortized cost in compliance with the provisions of Ind AS 109.

Impact

Companies may have to consider any guarantee fee paid or payable in future which is directly attributable to acquisition or issue of a financial liability as transaction costs while computing the effective interest rate of the financial instrument.

Accordingly, guarantee fees which were expensed out on an yearly basis will now be part of interest expense and will have an impact on the profit of the company.

EAC-2 Accounting for Funded Interest Term Loan (FITL) subsequent to restructuring of a loan taken from a shareholder

A company had taken a loan from one of its shareholders holding 26% of equity stake before the date of transition to Ind AS on which interest was unpaid. All unpaid interests on such loan were converted into funded interest term loan (FITL) with no interest being separate from original loan and terms of the original loan to be continued as per the originally agreed terms. While accounting for FITL, the company did not consider the FITL separately from the main term loan.

How should the restructured portion of the loan be accounted?

Key requirements

On the issue, the EAC opined the following:

- a) Considering the requirements of Ind AS 109, the company needs to determine the fair value of the FITL on the date of the financial restructuring, as its initial recognition amount.
- b) If it is determined that lender was acting in its capacity as a shareholder when providing interest-free financial support to the company, the difference between the nominal amount and the initial recognition amount of the FITL should be recognized as an

appropriate component of equity on transition to Ind AS. However, if it is determined that the lender is acting as a lender only, then the difference between the nominal amount and the initial recognition amount of the FITL would generally be recognized in the statement of profit or loss.

- c) The amortized cost of the FITL on the date of transition to Ind AS should be determined by unwinding the discount from the date of initial recognition to the transition date. The unwinding of the discount should be recognized as an adjustment in retained earnings on the transition.

Any restructured loan should be accounted for in accordance with principles of Ind AS 109 on transition to Ind AS. The company is required to determine the fair value of the FITL on the date of the financial restructuring, as its initial recognition amount in accordance with principles of Ind AS 109.

Impact

Any unpaid interest converted into funded interest term loan shall be considered separate from the original loan and accounted for as per the principles of Ind AS 109. Further, such conversion shall not result into revision in cash flows of the original loan.

7. Accounting Policies, Change in Accounting Estimates and Errors

7.1: Key clarifications from Educational Material on Ind AS 8, Accounting Policies, Change in Accounting Estimates and Errors

The Educational Material on Ind AS 8 addresses all relevant aspects envisaged in the standard by way of a brief summary and frequently asked questions (FAQs). The following are key

clarifications as stated in the FAQs:

- a) Prior period errors in interim financial statements and requirement of presentation of third balance sheet

1. *Is a company required to report the prior period error in the interim financial statements if the error is material to interim period but not material in context of annual financial statements?*

As per Ind AS 8 and Ind AS 1 on Presentation of Financial Statements, though materiality judgements always involve a degree of subjectivity, the overriding goal is to ensure that an interim financial report includes all the information that is relevant to an understanding of the financial position and performance of the company during the interim period. It is therefore not appropriate to base quantitative assessment of materiality on projected annual figures while evaluating errors in interim financial statements.

Accordingly, the management is required to correct the errors in the interim financial statements since it is assessed to be material in relation to interim period data.

2. *Is there a need for a company to present third balance sheet if a prior period error leads to reclassification of expenses?*

The reclassification of expenses from finance costs to other expenses would be considered as correction of an error under Ind AS 8. Ind AS 1 requires a company to present a third balance sheet at the beginning of the preceding period if it makes a retrospective restatement of items in its financial statements and the same has a material effect on the information provided in that balance sheet.

However, the retrospective restatement of relevant items in statement of profit and loss has no effect on the information in the balance sheet at the beginning of the preceding period. Therefore, the company is not required to present a third balance sheet.

b) Perceived conflict between application of Ind AS 8 and other Ind AS in case of a prior period error

1. *In case of discovery of a material error post measurement period in the purchase price allocation relating to acquisition which would have reduced the goodwill recognized on acquisition, should the goodwill be recomputed?*

Although the measurement period under Ind AS 103 has ended, a company would still be required to comply with the requirements of Ind AS 8 relating to correction of material prior period errors. The error in goodwill computation should be corrected as if the error had never occurred, i.e., by retrospectively adjusting the prior period financials. It would also need to be examined whether the correction has any additional implications with regard to initial or subsequent measurement of another asset or liability, tax effects or impairment.

2. *Error in recognition of a material amount of expenditure on development of an intangible item recognized as an expense.*

Ind AS 38 applies to those items of expenditure on an intangible item that were correctly recognized initially as an expense in accordance with the requirements of the standard. If an item is incorrectly recognized initially as an expense, the correction of the error in a later period was done by including the expenditure in the cost of an intangible asset

that is not inconsistent with, and therefore does not tantamount to non-compliance as per Ind AS 38. Hence, the expensing of the expenditure in the financial statements represents a prior period error.

c) Whether a change in an accounting policy is always required to be applied retrospectively? If not, what are the exceptions?

A change in an accounting policy that results from the initial application of an Ind AS should be accounted for in accordance with the specific transitional provisions, if any, of that Ind AS. In the absence of specific transitional provisions, or when a company changes an accounting policy voluntarily, it is required to apply the change retrospectively.

Retrospective application is subject to the following exceptions:

- (i) The initial application of a policy is to revalue assets in accordance with Ind AS 16, Property, Plant and Equipment, or Ind AS 38, Intangible Assets.
- (ii) Where it is impracticable to determine the period-specific effect or the cumulative effects of changing an accounting policy.

d) Voluntary change in accounting policy

1. *Whether a company can change its accounting policy of subsequent measurement of property, plant and equipment (PPE) from revaluation model to cost model?*

As per Ind AS 8, an accounting policy can be changed only if the change helps in providing financial statements reliable and more relevant information to the users. Hence a company can change from revaluation model to cost model for a class of PPE that can be made only if it meets

this condition. For example, a company planning an IPO may change its accounting policy from revaluation model to cost model for some or all classes of PPE to align the company's accounting policy with that of listed markets participants to enhance the comparability.

2. *A company decides to change its policy of measuring investments in subsidiaries (or associates or joint ventures) from cost to fair value in accordance with Ind AS 109, as this is likely to provide reliable and more relevant information in the financial statements.*

A company developed one of its accounting policies after considering a pronouncement of an overseas national standard-setting body in due accordance with Ind AS 8. Would it be permissible for the company to change the said policy to reflect a subsequent amendment in that pronouncement?

Ind AS 8 specifically deals with change in an accounting policy that is based on a pronouncement of International Accounting Standards Board (IASB)/other standard-setting body which is amended by the standard-setting body. As per Ind AS 8, such a change is a voluntary change in accounting policy. It can be made only if it results in providing reliable and more relevant information.

Impact

Companies will have to evaluate whether their existing application of the standard with respect to accounting policy, estimates and prior period error in their interim/annual or standalone/ consolidated financial statements is in line with the requirements.

8. Other changes

8.1: Key ITFG on applicability of Ind AS

Issue 1

Is a company required to mandatorily adopt Ind AS if its subsidiary is preparing its financial statements under Ind AS?

Summary of guidance

The Companies (Indian Accounting Standards) Rules, 2015 (Rules) deals with applicability of Ind AS to different class of companies. It broadly covers mandatory applicability of Ind AS under following three categories:

- i. Companies having their debt or equity securities listed or are in process of listing (listing criteria)
- ii. Companies having net worth above a threshold (net worth criteria)
- iii. Related companies (i.e., holding, subsidiary, associates and joint ventures of companies) covered in any of above criteria (relationship criteria)

If a company which is not covered under any Ind AS applicability criteria discussed above, acquires control of a company to which Ind AS is applicable only due to relationship criteria, both acquirer and acquiree will prepare their financials as follows:

In case of acquirer

Acquirer is not mandatorily required to adopt Ind AS if its subsidiary has adopted Ind AS due to relationship criteria. It is also not mandatorily required to prepare its financials under Ind AS due to listing or net worth criteria.

In case of acquiree

Once a company starts following the Ind AS either voluntarily or mandatorily, it is required to follow the Ind AS for all the subsequent financial statements even if any of the criteria specified in the Rules does not subsequently apply to it. Accordingly, having adopted Ind AS, the

subsidiary will be required to prepare its financial statements under Ind AS framework only.

Impact

ITFG has provided important clarifications regarding applicability of Ind ASs.

It has been clarified that Ind AS is not applicable by virtue of relationship criteria unless either of the company covered under the relationship criteria is required to apply Ind AS by virtue of net-worth or listing criteria. Therefore, in the above example, if the subsidiary was required to apply Ind AS due to net-worth or listing criteria, acquirer would be also required to follow Ind AS.

Further, it has also been reiterated that if due to change in organization structure, a company fails to maintain relationship or other applicability criteria, it will still be required to use Ind AS for financial reporting purposes if Ind AS has been adopted either voluntarily or mandatorily in any previous reporting period.

Though the clarification deals with scenario when a company acquires control of other company, principles discussed are equally applicable to other relationships (e.g., associate company) covered by relationship criteria.

8.2: Other Expert Advisory Committee (EAC) Opinions - Accounting treatment of expenditure relating to onerous contracts

Ind AS 37 defines an onerous contract. This means a contract in which the unavoidable costs of meeting the obligations exceed the economic benefits expected to be received under it.

Which costs should be included in providing for such onerous contracts?

Key requirements

Ind AS 37 provides that the amount recognized as a provision shall be the best estimate of the expenditure required to settle a present obligation.

This includes the amount a company would rationally pay to settle the obligation at the end of the reporting period or transfer it to a third-party at time of settlement. The EAC opined that in the case of onerous contracts, the amount a company would rationally pay to settle an obligation would be the lower of the compensation or penalties arising from its failure to fulfil the terms of the contract and the excess of the unavoidable costs of meeting the obligations under the contract from the economic benefits expected to be received under it.

Paragraph 68 of Ind AS 37 uses the expression unavoidable costs of the meeting the obligations under the contract. These costs include direct labor, direct material and allocation of costs related directly to contract activities. In context of the issue raised by querist as above, the EAC noted that the company had not considered its administrative overheads, finance charges, R&D expenses, sales overheads and its headquarters' expenditure while creating a provision for the onerous contract. Therefore, the committee opined that generally such costs do not relate directly to a contract, and therefore, should not be considered while creating a provision for an onerous contract.

Furthermore, since Ind AS 37 requires provision of all costs to fulfil obligations under a contract, in a contract to supply a product, the costs should include all expenditures till the supply of the product, including the cost of supplying the product.

Impact

Companies need to consider all incremental costs to fulfil obligations under a contract while calculating the amount of provision for fulfilling onerous contracts. In this connection, there is a need for companies to ensure that the only costs which are unavoidable are the ones that are directly attributable to such contracts. Hence, no administrative costs or allocated overheads should form a part of provision for onerous contracts.

An overhead view of three people working together at a wooden desk. One person is pointing at a tablet displaying architectural blueprints. Another person is using a pen to point at a laptop screen. A third person is also pointing at the laptop screen. The desk is cluttered with various items including a pen, paper clips, and a small black object.

Section 2:

New Auditing pronouncements applicable to financial statements of FY 2019-20 or thereafter

The following pronouncements are related to auditing standards and auditors report. The requirements of these pronouncements are crucial for the management since auditors are likely to demand enhanced information from management to discharge their reporting responsibilities. Companies may also need to strengthen their internal controls systems to ensure robustness of data/information provided to auditors.

1. The Companies (Auditor's Report) Order, 2020

Key requirements

The Ministry of Corporate Affairs vide its notification dated 25 February 2020 issued the Companies (Auditor's Report) Order, 2020 (CARO 2020) in supersession of the existing the

Companies (Auditor's Report) Order, 2016 (CARO 2016) after consultation with National Financial Reporting Authority (NFRA) constituted under section 132 of the Companies Act, 2013.

Every report made by the auditor under section 143 of the Companies Act, 2013 on the accounts of every company audited by them, to which this order applies, for the financial years commencing on or after the 1 April 2020, must contain a report on matters specified in paragraphs 3 and 4 of the CARO 2020.

This order is called **the Companies (Auditor Report) Order, 2020**.

Applicability: it applies to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2013 (18 of 2013).



The government's announcement to defer CARO 2020 is a big relief for Indian corporates and auditors since all companies are grappling with uncertainties due to the outbreak of Coronavirus. However, it is important for companies to focus on new requirements as CARO 2020 will apply to all transactions from 1 April 2020. They should stress-test their systems and processes to ensure that the requisite information is compliant with CARO 2020.

Ajith Thambi

Director, Financial Accounting Advisory Services (FAAS), EY India

Exceptions

- i) A banking company.
- ii) An insurance company
- iii) A company licensed to operate under section 8 of the Companies Act, 2013.
- iv) A one person company as defined in section 2(62) of the Act and a small company as defined in clause 2(85) of the Act
- v) A private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than INR 1 crore as on the balance sheet date and which does not have total borrowings exceeding

New reporting requirements

Going concern	Auditor to consider financial ratios, ageing and expected dates of realization of financial assets/payment of financial liabilities, other information and their knowledge of Board of Directors and management plans; and Opine on whether any material uncertainty exists as on the date of audit report that a company is capable of meeting its liabilities existing at the balance sheet date as and when they fall due within a period of one year from the balance sheet date.
Cash losses	Has the company incurred any cash losses in the current FY and in the immediately preceding FY and the amount of such cash losses. This requirement has been reinstated from CARO 2003.
Default in repayment of loans	Increased reporting requirements on: <ul style="list-style-type: none"> ▶ Default in repayment of loans and interest thereon from any lender in the prescribed format, unlike only banks, financial institutions, government or debenture holders in CARO 2016. ▶ Declaration of willful defaulter by any bank or financial institution or other lender. ▶ Whether term loans were applied for the purpose for which it was obtained and the amount of diverted funds and the purpose for which such funds are used. ▶ Short-term funds utilized for long term purposes. This requirement has been reinstated from CARO 2003. ▶ Any funds obtained from any entity/ person on account of or to meet the obligations of its subsidiaries, associates or joint ventures. ▶ Loans raised during the year on the pledge of securities held in its subsidiaries, joint ventures or associate companies; details to be reported and if the company has defaulted in repayment of such loans raised.

New reporting requirements	
Working capital loans	New reporting on whether quarterly returns or statements filed with banks or financial institutions on the basis of current assets security for sanctioned working capital limits in excess of INR5 crores in aggregate are in agreement with the books of account, and if not, details to be reported.
Investments, guarantees, loans and advances	<p>If the company has made investments in, provided guarantees or security in addition to loans or advances in the nature of loans, secured or unsecured, to any entity (as against the parties covered under Section 189 of the Companies Act, 2013 in the erstwhile clause), additional reporting is required for:</p> <ul style="list-style-type: none"> ▶ Loans or advances in the nature of loans granted, guarantees provided or security given to any other entity (applicable to all companies other than those who are in the principal business of giving loans). If so, the company is required to report the aggregate amount during the year and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security to (a) subsidiaries, joint ventures and associates and (b) other parties, separately. ▶ Whether investments made, guarantees provided, security given and the terms and conditions of the grant of all loans and advances in the nature of loans and guarantees provided are prejudicial to the company's interest. ▶ Any loan or advance in the nature of loan granted, which has fallen due during the year, has been renewed or extended or fresh loans granted to settle the overdues of existing loans given to the same parties, additional disclosure with respect of renewal of loans /extension of loans/ existing loans settled by granting fresh loans and the percentage of the aggregate to the total loans or advances in the nature of loans granted during the year is required to be made (not applicable to companies whose principal business is to give loans). ▶ The company that has granted any loans or advances in the nature of loans either repayable on demand or without specifying any terms or period of repayment, reporting on the aggregate amount and percentage, thereof on the total loans granted and their aggregate amount granted to promoters as well as related parties as defined in section 2(76) of the Act.
Property plant and equipment (PP&E)	<ul style="list-style-type: none"> ▶ New reporting on maintenance of proper records showing full particulars of intangible assets. ▶ Additional disclosures and reporting requirements for revaluation of PP&E (including Right-of-Use assets) and intangible assets undertaken during the year. Specific reporting on revaluation of 10% or more in aggregate net carrying value of each class of PP&E or intangible assets and reporting as to whether such revaluation is based on the valuation by a registered valuer. ▶ Proceedings initiated or pending against the company for holding any benami property defined under the Benami Transactions (Prohibition) Act, 1988.
Core investment companies, Nonbanking Financial Companies and Housing Finance Companies	<ul style="list-style-type: none"> ▶ Any non-banking financial or housing finance activity conducted before obtaining a certificate of registration. ▶ Whether a company is a core investment company (CIC) or exempted or unregistered CIC and continues to fulfil such criteria. ▶ Total number of CICs which are part of a group, in case, the number of CIC is more than one.
Nidhi company	Reporting on default in payment of interest on deposits or repayment for any period.
Fraud	<p>Whether auditor has reported under section 143(12) of the Companies Act, 2013 by filing Form ADT-4 with the Central Government.</p> <p>Whether whistle blower complaints received during the year by the company have been considered by the auditors.</p>
Internal audit reports	New reporting on the internal audit system of the company being commensurate with the size and nature of the business of the company and whether reports of internal auditors considered by statutory auditor. This requirement has been reinstated from CARO 2003.
Resignation of statutory auditors	Incoming statutory auditors to report on consideration of concerns/objections raised by outgoing statutory auditor of the company.
Unrecorded income subsequently recorded	Reporting on any transactions not recorded in the books of account but surrendered/disclosed as income during the year in the tax assessments under the Income Tax Act, 1961 and if such unrecorded income has been recorded in the books of account during the year.
Corporate social responsibility	<ul style="list-style-type: none"> ▶ Compliance of second proviso to section 135(5) of the Act – transfer of unspent amount to a fund as specified in Schedule VII (other than on going project). ▶ Reporting on compliance with the provision of section 135(6) of the Act – any amount remaining unspent under section 135(5) of the Act, pursuant to any ongoing project, has been transferred to special account. <p>It may be noted that second proviso to Section 135(5) and Section 135(6) of the Act are yet to be notified by the MCA.</p>
Consolidated financial statements (CFS)	<ul style="list-style-type: none"> ▶ Qualification/adverse remarks in CARO in the audit report of companies which are consolidated in the CFS will be required to be reported.

Requirements with enhanced reporting from CARO 2016	
Loans and advances	<ul style="list-style-type: none"> ▶ The ambit of reporting enhanced to include advances as well. In respect of loans and advances in the nature of loans, reporting on whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular. ▶ If the amount of loans and advances is overdue, the total amount that is overdue for more than 90 days has to be disclosed. Besides this, it is important to report whether reasonable steps have been taken by the company for recovery of the principal and interest.
Property, plant and equipment	<ul style="list-style-type: none"> ▶ Aligned to the terminology used in Ind AS 16 and AS 10 on Property, Plant and Equipment instead of Fixed Assets. ▶ Clarification on reporting on title deeds of all the immovable properties (other than leasehold properties where the company is the lessee and the lease agreements are duly executed in favor of the lessee).
Inventory	Coverage and physical verification of inventory along with reporting whether discrepancies of 10% or more in the aggregate was noticed for each class of inventory and whether such discrepancies have been properly dealt in the books. Earlier, the clause required reporting with respect to only material discrepancies recorded in the books of account.
Fraud	Earlier, the reporting was restricted to fraud committed by the company or on the company by its officers or employees. Revised clause requires reporting on any fraud by the company or any fraud on the company, i.e., reporting on fraud is not limited to frauds committed by the officers or employees of the company while reporting under this clause.
Statutory dues	<p>Clarification on payment of undisputed Goods and Service Tax on account of introduction of Goods and Service Tax in India.</p> <ul style="list-style-type: none"> ▶ Increase in reporting requirement with respect to all statutory dues which are disputed. Earlier the reporting was limited with respect to disputed income tax, sales tax or service tax or customs duty, excise duty or value added tax.
Deposits	Slight modification has been made to the existing clause to include deemed deposits.
Preferential allotment or private placement of shares or debentures	Slight modification has been made to the existing clause to provide more clarity. Previously, only specific reference to section 42 of the Companies Act, 2013 for private placement of shares or debentures and no reference made to section 62 of the Act which deals with preferential allotment.

Requirements carried forward with no modifications	
Reporting under section 185 and 186	In respect of loans, investments, guarantees and security whether provisions of section 185 and 186 of the Companies Act, 2013 have been complied with. If not, it is important to provide the details thereof.
Cost records	Whether maintenance of cost records has been specified by the Central Government under sub-section (1) of section 148 of the Companies Act, 2013 and whether such accounts and records have been so made and maintained.
Nidhi company	<ul style="list-style-type: none"> ▶ Whether the Nidhi company has complied with the net owned funds to deposits in the ratio of 1: 20 to meet out the liability. ▶ Whether the Nidhi company is maintaining 10% unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability.
Related party transactions	Whether all transactions with the related parties are in compliance with section 177 and 188 of Companies Act, 2013, where applicable, and the details have been disclosed in the financial statements, as required by the applicable accounting standards.
Non-cash transactions	Whether the company has entered into any non-cash transactions with directors or persons connected with the directors and if so, whether the provisions of section 192 of the Companies Act, 2013 have been complied with.
Registration under section 45-IA of the RBI Act	Whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934 and if so, whether the registration has been obtained.
Public issue	Whether moneys raised by way of Initial Public Offer or further public offer (including debt instruments) during the year were applied for the purposes for which those were raised, if not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported.

Requirement not carried forward from CARO 2016	
Managerial remuneration	Subsequent to the amendment of section 197 of the Companies Act, 2013 in September 2018, the clause on reporting on managerial remuneration paid/provided in accordance with the requisite approvals mandated by the provisions of Section 197 is required to be reported under Other Legal and Regulatory Requirements section of the audit report along with CARO 2016, thereby leading to duplicity. CARO 2020 has removed the duplicity of this reporting requirement.



CARO 2020 has made auditors' reporting more onerous while mandating significant reporting and disclosures in the audit report. Some of the reporting requirements significantly expand the scope of audit, require higher level of professional judgement and skepticism from auditors, and provide more information to the stakeholders.

Dilpesh Chouhan

Director, Financial Accounting Advisory Services (FAAS), EY India

Impact

While CARO 2020 enhances reporting responsibilities for auditors, it has significant impact on the companies as well. Auditors will require significant information about the new clauses. In many cases, it will require reconciliation of information furnished with various lenders as well as regulators. Companies will need to beef up their internal control system so that information furnished to various regulators and lenders is subjected to the same rigor and controls as followed for financial statements. Companies need to realign their Financial Statements Close Process (FSCP) and internal control over financial reporting to ensure that information and data relating to clauses in CARO are compiled appropriately and on timely basis to avoid any adverse comments in the CARO report.

It should also be noted that new clause (xxi) in CARO 2020 will apply on the consolidated financial statements. It requires auditors of holding companies to include details of the companies and those paragraph numbers of CARO report that contain the qualification/adverse remarks by the respective auditors. Parent companies need to align the audit schedule of each of the group companies as any CARO qualification relating to subsidiary will also have impact on CARO report of parent companies.

2. Implementation guide to provide practical guidance on implementation of the principles enunciated in the Standard on Auditing (SA)

I. Implementation guide to SA 570: Going Concern

The SA 570 (Revised) deals with the auditor's responsibility in the audit of financial statements with respect to management's use of the going concern assumption in the preparation and presentation of the financial statements. It also deals with the implications of going concern assumption for the auditor's report. The standard is applicable for audits of financial statements for periods beginning on or after 1 April 2017.

A detailed analysis for testing indicators/factors regarding uncertainty of going concern is summarized as follows:

- A list of financial, operating and other indications while considering whether there is a risk that the company will not continue as a going concern for the foreseeable future. This factor has also been stated in para A3 of the standard.
- Evaluating whether the company has the managerial ability to continue as a going concern based on its knowledge

of events or conditions and related business risk.

- Factors to be considered while assessing management plan for dealing with adverse effects of the identified conditions and events and assess the likelihood of effect of implementation thereof. These may include plans to dispose the asset, borrow money or restructure debt, reduce or delay expenditure, etc.
- Obtain management representation when additional disclosures are made in the financial statement relating to company's ability to continue as a going concern and also any other additional matters.
- To ensure adequacy of disclosure in the financial statements by describing principal conditions and events that raised doubts about a company's ability to continue as a going concern for the foreseeable future, it is important to describe possible effects of such conditions and events and management's evaluation of the significance of those conditions.
- Ensuring whether the presentation of the financial statements conforms with professional standards and the applicable legal or regulatory requirements. It is important to consider whether material transaction or items that may require separate disclosure and accounting policies used in the financial statements are appropriate and consistent with the prior period, and balances and associated disclosures are presented in accordance with accounting principles.

II. Implementation guide to SA 720: The Auditors Responsibilities Relating to Other Information

The Standard on Auditing (SA) 720 (Revised) deals with the auditor's responsibilities relating to other information, whether financial or non-financial information (other than financial statements and the auditor's report thereon), included in a company's annual report. The standard is

applicable for audits of financial statements for periods beginning on or after 1 April 2018.

Reporting under SA 720 has become very important as companies are increasingly and more diversely using documents to communicate with their stakeholders in connection with the issuance of audited financial statements. This has led to an increase in users' need for clarity in the auditor's report regarding the auditors' involvement with such other information.

The guidance highlights the responsibilities of the auditors as:

- ▶ The auditor's consideration of other information is intended to result in a more active work effort than the earlier requirement that only read the other information.
- ▶ The standard requires the auditor to compare selected amounts or other items in the other information with such amount or items in the financial statements. The word selected in the requirement is important to convey that professional judgement is applied.
- ▶ Even though the standard sets boundaries w.r.t the other information based on knowledge obtained in the audit and the audit evidence obtained, and conclusion reached in audit, the guidance clarifies that the auditor may make other inquiries as necessary.
- ▶ The guidance emphasizes on appropriate documentation as per the new requirement.

3. Procedure under SEBI Listing Obligations and Disclosure Requirements circular on Regulation 33(8)

The SEBI circular on Regulation 33(8) specifies the procedure and formats for limited review/audit report of the listed company and those companies whose

accounts are to be consolidated with the listed company.

SEBI, while considering the recommendation of the Kotak Committee with respect to regulatory framework for Group Audit, decided to amend Regulation 33 of the SEBI (Listing Obligation and Disclosures Requirements) Regulations, 2015 (SEBI LODR Regulations).

Accordingly, the following new sub-regulation was inserted which came into effect from 1 April 2019.

“(8) The statutory auditor of a listed company shall undertake a limited review of the audit of all the companies/ companies whose accounts are to be consolidated with the listed company as per AS 21 in accordance with guidelines issued by the Board on this matter”.

Thus, all listed companies whose equity shares and convertible securities are listed on a recognized stock exchange and their statutory auditors as well as those companies whose accounts are to be consolidated with the listed company and their statutory auditors are required to comply with the procedures and formats given in the schedule.

The objective of this procedure is that it will allow the auditors to obtain the desired information as required under the Standard on Auditing (SA) 600, “Using the Work of Another Auditor” and the Guidance Note (GN) on Audit of Consolidated Financial Statements (Revised 2016) issued by the ICAI in order to rely on the work of the auditors while forming and expressing an opinion/conclusion, as applicable, on the consolidated financial statements/results of the parent company under Regulation 33(8) of SEBI LODR Regulations.

Clarification on a limited review

A review is limited primarily to inquire about a company's personnel and analytical procedures applied to financial data and thus provides less assurance than an audit. The auditor does not perform an audit and accordingly, does not express an audit opinion.

Important note for the companies and auditors

- a) Some of the procedures specified in this circular are in addition to the requirements of SA 600 “Using the Work of Another Auditor”, the Guidance Note on Audit of Consolidated Financial Statements and SRE 2410/2400, including providing clarification thereon and do not replace these standards/ guidance note.
- b) The audit and limited review of the respective components that are being consolidated with the parent company shall continue to be undertaken by the respective auditors of such components. The amended SEBI Listing Regulations do not require the statutory auditor to perform all procedures by replacing the existing statutory auditor of the respective components.

Key requirements of the procedure include:

Role of principal auditor

- ▶ Obtain understanding of consolidation process followed by the parent company's management and instructions issued by it.
- ▶ Principal auditor to determine significant components based on discussions with other auditors and component management. The significant revenues, assets and profits if consolidated, should aggregate to at least 80% of each of the consolidated revenue, assets and profits.
- ▶ Determine materiality for the consolidated financial statements as a whole.
- ▶ While planning to use work of other auditor, consider professional competence of the other auditor in context with the specific assignment.
- ▶ Send group audit/review instructions to component auditors for audit/review of the consolidated financial statements/results.
- ▶ Determine the nature, timing and extent of the procedures to be performed and also perform procedures to obtain sufficient appropriate audit evidence that the work of the other auditors is appropriate in the context of the assignment.
- ▶ Circulate a detailed questionnaire to the component auditors, which they should respond on a timely basis.
- ▶ Design and perform review procedures on consolidated financial statements arising from the special consideration relating to the consolidation process.
- ▶ Principal auditor should consider discussing significant findings of the other auditors and may consider it appropriate to discuss with the other auditors and the management of the component. He may also decide conducting supplement tests of the records or the financial statements of the component.
- ▶ When principal auditor concludes that the financial information of a component is immaterial, the procedures outlined in SA 600 do not apply. When several components, immaterial in themselves, are together material in relation to the financial information of the company as a whole, the procedures outlined in SA 600 should be considered.
- ▶ Obtain Management representation including those relating to the consolidated financial statements/results.
- ▶ Evaluate and consider all reporting considerations including those communicated by the other auditors.
- ▶ Include the matters specified in SA 600 Para 18 in the audit/review documentation.

Role of component auditor

- ▶ Provide an acknowledgement to the principal auditor for the receipt of the instructions, where applicable.
- ▶ Perform the procedures required by the principal auditor based on the instructions received.
- ▶ Provide a confirmation to the parent auditor regarding compliance with the instructions received along with the applicable audit/review report.

The circular also specifies the list of requirements the principal auditor should communicate to other auditors on a timely basis. This communication shall set out the work to be performed, its impact and the form and content of the other auditors' communication with the principal auditor.

The management of the parent auditor will be responsible for ensuring compliance with the requirements of the circular including providing a confirmation from the component auditor to the parent auditor regarding compliance with the instructions received, together with the applicable audit/review report.

Further, the SEBI Amendment Regulations also require the listed entity/auditors thereof to ensure, for the purpose of quarterly consolidated financial results, that at least 80% of each of the consolidated revenue, assets and profits, respectively shall have been subject to audit/review. SEBI Circular also clarifies that the principal auditor should determine significant components in such a manner that those components which together with the Parent Company would in the aggregate represent at least eighty percent of each of the consolidated revenue, assets and profits.

SEBI has issued the formats for limited review reports and audit reports that is applicable from 1 April 2019.

Impact

While above guidance are relevant for auditors, some key areas that require the attention of companies based on guidance are given above:

1. If there are indicators which impact going concern assessment, then company will need to furnish a detailed evaluation of management assessment of its ability to continue as a going concern based on its knowledge of events or conditions and related business risks. Factors to be considered in management's assessment are plan for dealing with adverse effects of the identified conditions and events and assess the likelihood of effect implementation plan thereof. These may include plans to dispose the asset, borrow money or restructure debt, reduce or delay expenditure, etc. Auditors may demand a detailed discussion and representation with/from relevant stakeholders like Board of Directors, audit committee, etc.
2. Companies need to ensure that all the information (financial and non-financial) disclosed in the annual report is aligned with their financial statements. Besides this, they should be design appropriate internal controls to ensure completeness, accuracy and disclose appropriateness of information in the annual report.
3. SA 600 requires principal auditors to determine significant components based on the discussions with other auditors and other component management. The significant revenues, assets and profits if consolidated, should aggregate to at least 80% of each of the consolidated revenue, assets and profits. It is also important to have the audit coverage of all the components in the group. For this, companies need a proactive dialogue with the auditors on this matter.

Section 3:

Regulatory changes and other developments



1. The Companies (Amendment) Act, 2019

On 2 November 2018, the Ministry of Law and Justice had issued the Companies (Amendment) Ordinance, 2018 and made certain amendments to the provisions of the Companies Act, 2013 (the Act). But on 31 July 2019 the ministry issued the Companies (Amendment) Bill, 2019 which along with new amendments, includes the amendments made by the said ordinance. The following are the significant ones which were introduced recently:

Key requirements

a. Corporate Social Responsibility (CSR)

At first, it is important to note that the notification for the amendment of the CSR provision under section 135 of the Companies Act, 2013 has mentioned that the date from which these amendments will be effective will be separately notified. However, these are yet to be notified. Following are the details of the proposed change:

- ▶ The amount of CSR contribution shall be calculated on the average of net profits for the years since the incorporation for the companies who have not completed three years.
- ▶ The unspent CSR amount, other than the amount that relates to any ongoing projects, is required to be transferred to any of the funds mentioned in Schedule VII of the Act, within a period of six months from the end of the financial year.
- ▶ The unspent amounts in relation to ongoing projects should be

transferred to a separate bank account within 30 days from the end of financial year. Further, such amount should be spent within a period of three financial years from the date of such transfer. If such amount remains unspent after a completion of three financial years, the said amount is then required to be transferred to any of the funds mentioned in Schedule VII, within a period of 30 days from the date of completion of the third financial year.

- ▶ If a company contravenes the above provisions, newly-introduced penal provisions would apply. This includes a punishment with a fine which should not be less than INR50,000, but which may extend to INR25,00,000. Also, every officer of the company who is in default would be punishable with imprisonment for a term which may extend to three years or with a fine which should not less than INR50,000 but which may extend to INR5,00,000 or may include both.

Impact

If the effective date for the above provisions is not notified by MCA before 31 March 2020 then there would be no impact of the above for the current financial year. However, if does get notified, companies may have to comply with the same by transferring the unspent amount as per the requirements or bear the penal consequences.

Also, presently, the ICAI guidance note on Accounting for Expenditure on Corporate Social Responsibility Activities had clarified that no provision is required for the amount which is not spent i.e., any shortfall in the amount that was expected to be spent at the end of the reporting period may not

be made in the financial statements considering there were no consequences of not spending the amount. However, if this amendment gets notified, the companies would have to evaluate whether a provision for the unspent amount needs to be created in the financial statements for the year ended 31 March 2020.

b. Application for different financial year

Section 2 (41) of the Companies Act, 2013 relates to the new definition of financial year. It includes a company or body corporate which is a holding company, or a subsidiary or associate company of a company incorporated outside India and is required to follow a different financial year for consolidation of its accounts outside India, the company may make an application to the Central Government to allow any period as its financial year, whether or not that period is a year.

Impact

Erstwhile, for change in the financial year under section 2(41) of the Companies Act, 2013, the companies would have to take an approval from National Company Law Tribunal (NCLT) through a petition. Now, this amendment has shifted the requirement for approval for following a different financial year from NCLT to the central government.

2. Amendment to Schedule VII of the Companies Act, 2013

Key requirements

The MCA has added an activity pertaining to disaster management, including relief, rehabilitation and reconstruction activities to the list of permitted activities that qualify as CSR activities by companies.

Impact

This amendment is effective from the date of its publication in the official gazette and hence companies may now consider spending their amounts dedicated for CSR towards the above-mentioned exercise also.

3. The Companies (Share Capital and Debentures) Rules, 2019

The MCA on 16 August 2019 amended the provisions of the Companies (Share Capital and Debentures) Rules, 2014 with respect to the holding of equity shares with differential voting rights by a company and provisions pertaining to creation of debenture redemption reserve.

Key requirements

a. Amendments to the requirements for issuing equity shares with Differential Voting Rights (DVRs)

- ▶ The amendment states that the voting power in respect of shares with differential rights of the company shall not exceed 74% of total voting power, including the voting power in respect of equity shares with differential rights issued at any point of time.
- ▶ A company need not have a consistent track record of distributable profits for the last three years to be able to issue DVRs.

Impact

The Companies (Share Capital and Debentures) Rules, 2019 apply to all unlisted public companies, private companies and listed companies so far as they do not contradict with any provision framed by the Securities and Exchange Board of India (SEBI). However, for listed companies, one will have to read it in conjunction with the framework issued by SEBI.

The erstwhile laws had restricted the issue of equity shares with differential voting rights to 26% of the post-issue paid up equity share capital and only if a company had distributable profits for past three years. The amendment has now brought relief to companies by allowing them to issue equity shares with DVRs to the extent that the voting power in respect of the DVRs does not exceed 74% of the total voting rights.

The above change in restriction and also in the removal of the requirement for having distributable profits may enable promoters of Indian companies to retain control of their companies and still raise equity capital from global investors.

b. Amendments with respect to creation of Debenture Redemption Reserve

Key requirements

The MCA has amended the Companies (Share Capital & Debentures) Rules 2014 and removed debenture redemption reserve requirement for listed companies, NBFCs and Housing Finance Companies (HFC).

The decision has been taken in pursuance of the government's objectives of providing greater 'Ease of Doing Business' to companies in the country as part of its 100 Days Action Plan.

- ▶ As per the amendment, the Debenture Redemption Reserve (DRR) to be created out of profits of the company available for payment of dividend is now not required for the following companies in both cases (whether public issue or privately placed debentures):
 - ▶ Debentures issued by All India Financial Institutions regulated by RBI and Banking Companies
 - ▶ For NBFCs registered with RBI under 45-IA and Housing Finance Companies registered with National Housing Bank
 - ▶ All other listed companies
- ▶ For unlisted companies, the adequacy of DRR shall be 10% of the value of outstanding debentures.

The following table provides a summary of the comparison of the erstwhile and amended provisions for different companies:

Sr no	Type of company	Erstwhile provision		Amended provision	
		Whether DRR to be maintained	Whether investment or deposit in specified securities to be maintained*	Whether DRR to be maintained	Whether investment or deposit in specified securities to be maintained*
	All India Financial Institutions regulated by RBI and Banking Companies (Listed and Unlisted Companies)	No DRR required for both public as well as privately placed debentures.	No	No DRR required for both public as well as privately placed debentures.	No
	Listed NBFCs registered with RBI under section 45-IA of the Reserve Bank of India Act, 1934 and listed Housing Finance Companies registered with National Housing Bank	DRR required to the extent of 25% of the value of outstanding debentures in case of public issue and no DRR required for private placements	Yes, for public issue and No for private placement	No DRR required for both public as well as privately placed debentures.	Yes, for both public issue and private placement
	Unlisted NBFCs registered with RBI under section 45-IA of the Reserve Bank of India Act, 1934 and unlisted Housing Finance Companies registered with National Housing Bank	No DRR required for privately placed debentures.	No	No DRR required for privately placed debentures.	No
	Other listed companies	DRR required to the extent of 25% of the value of outstanding debentures in case of public and private placements	Yes	No DRR required for both public issue as well as privately placed debentures	Yes
	Other unlisted companies	DRR required to the extent of 25% of the value of outstanding debentures in case of private placements	Yes	DRR required to the extent of 10% of the value of outstanding debentures in case of private placements	Yes

*Requirements of investment or deposit in specified securities as per Rule 18(1)(c) Companies (Share Capital and Debentures) Rules 2014 remains unchanged.

Impact

The erstwhile provisions of Section 71(4) read with Rule 18(1)(c) of the Companies (Share Capital and Debentures) Rules, 2014 required every company issuing redeemable debentures to create a DRR of at least 25% of outstanding value of debentures for the purpose of redemption of such debentures. Besides this, such companies were required to either deposit, before 30 April each year, in a scheduled bank account, a sum of at least 15% of the amount of its debentures maturing during the year ending 31 March of the next year or invest in one or more securities enlisted in Rule 18(1)(c) of the Companies (Share Capital & Debentures) Rules 2014. After the amendment, the above requirements are done away with.

4. The Specified Companies (Furnishing of information about payment to Micro and Small enterprise suppliers) Order, 2019

Key requirements

Dues to Micro and Small Enterprises: every company shall file MSME Form I detail of all outstanding dues to MSMEs suppliers existing within 30 days from the date of notification of the order which is 22 January 2019.

Further, MSME Form I would be filed by the companies every half year, i.e., by 31 October for April to September and by 30 April for October to March.

The MSME Form I should carry the following details:

- ▶ The amount of payment that is due
- ▶ The reasons of the delay

Impact

Companies shall ensure that the disclosures made under MSME Form I matches with the disclosures made in financial statement for MSME as per Schedule III. Also interest payable on amount outstanding shall be same as disclosed in MSME Form I.

5. The Companies (Significant Beneficial Ownership) Amendment Rules, 2019

Key requirements

Declarations for Significant Beneficial Ownership: every company has been assigned a responsibility to identify any individual who is a significant beneficial owner in relation to the reporting company to make a declaration in Form No. BEN-1. Such declaration should be submitted within 90 days from the commencement of the Companies (Significant Beneficial Owners) Amendment Rules, 2019 which is 08 February 2019 and if any individual becomes a significant beneficial owner after the commencement date and changes take place to the existing significant beneficial ownership, they need to be filed within 30 days of such acquisition of significant beneficial ownership or changes therein.

Upon the receipt of BEN-1, the reporting company needs to file BEN-2 in respect of such declaration within a period of 30 days of such receipt of the declaration.

Impact

The company may witness an impact on compliance of related-party transaction provisions of the Companies Act and SEBI LODR, 2018 with respect to individuals identified as having significant beneficial ownership as per above requirement. Also, a company may have to evaluate whether such significant beneficial ownership impacts control criteria as per Ind AS 110.

6. Amended threshold for related-party transactions

Key requirements

The MCA on 18 November 2019 vide a notification of the Companies (Meeting of Board and its Powers) Second Amendment Rules, 2019 (Second Amendment Rules, 2019) issued further amendment to Rule 15 of the Companies (Meeting of Board and its Powers) Rules, 2014.

Under the revised threshold limits (10% or more of turnover, or 10% or more of net worth), a company would require approval of shareholders by way of a resolution for various related-



Related party compliance is one of the key focus areas for a majority of the companies. Companies should re-wire their systems to ensure approvals are in accordance with the revised rules under the Companies Act, 2013. They should closely monitor the future developments arising from the recommendations of the SEBI's working group to avoid the last-minute compliance hurdles.

Veenit Surana

Director, Financial Accounting Advisory Services (FAAS), EY India

party transactions such as sale and purchase of goods through an agent, sale or disposal of a property, leasing of property or availing or rendering any services through an agent.

A working group was constituted by SEBI in November 2019 to review the policy space pertaining to related party transactions. It has submitted a list of recommendations to SEBI outlining various areas like definition of related-party and related-party transactions, thresholds for materiality, process for audit committee approvals for related party transactions, review of existing provisions, format for periodic disclosure of related-party transactions by listed companies, recommendations for strengthening the monitoring and enforcement of regulatory norms related to related party transactions and other matters. The changes are not yet notified.

Impact

Companies should continue to maintain or upgrade their systems and processes to ensure related-party transactions are appropriately captured, reported and approved across various requirements.

The MCA vide the Second Amendment Rules, 2019 seeks to revise the threshold limits pertaining to any contract or arrangement with a related party for transaction value beyond which the company would require an approval of shareholders by way of a resolution.

The companies shall track the amendment on this aspect to see whether the recommendations of the working groups are accepted by the SEBI, once SEBI notifies them. Also, companies should gear up to ensure readiness to comply with recommendations of the working group to avoid the last minute hurdles in compliance.

7. MCA issues circular to remove ambiguities in appointed date and acquisition date with respect to mergers/ amalgamations

Key requirements

The MCA has issued a circular dated 21st August 2019 clarifying section 232(6) of the Companies Act, 2013, which deals with the requirement of indicating an appointed date and the relevance of effective date in the scheme of mergers and amalgamations.

The circular clarifies that the companies may choose the appointed date of the merger/amalgamation based on occurrence of an event, which is relevant to the merger between companies. This would allow the concerned companies to function independently till such event is actually materialized.

The circular further clarifies that the term appointed date used in section 232(6) shall be deemed to be the acquisition date for the purpose of conforming to accounting standard Ind AS 103 that deals with business combinations.

This clarification would lead to harmonization of practices in ascertaining the appointed date of merger/amalgamation and provide due clarity on the accounting treatment, thereby allowing stakeholders to align the appointed date of merger/ amalgamation in accordance with their business considerations or legal requirements.

Impact

While the circular may suggest that appointed date can be ante-dated for statutory and regulatory purposes, such appointed date may not align with date of acquisition as per Ind AS 103 and Ind AS 110. It may be noted that the Accounting Standards Board of the ICAI has also acknowledged that if the appointed date were ante dated,



While the circular may suggest that appointed date can be ante-dated for statutory and regulatory purposes, it may not align with date of acquisition as per Ind AS 103 and Ind AS 110. In such cases, companies should consult their auditors to consider the impact on their audit reports as per the auditing standards.

Charanjit Attra

Partner, Financial Accounting Advisory Services (FAAS), EY India

it may result into carve out from Ind AS 103, Business Combinations, hence from accounting perspective, if there is any deviation in appointed date as per the Scheme filed with the National Company Law Tribunal ("NCLT") from the acquisition date as identified in accordance with Ind AS 103, the companies should consult their auditors to consider the impact on audit report in accordance with reporting standards.

8. SEBI defers the timeline for separation of the roles of non-executive chairperson and MD/CEO by two years

Section 203 of the Companies Act, 2013 provides that an individual should not be appointed/reappointed as the chairperson of a company, as well as its managing

director (MD) or a chief executive officer (CEO), unless allowed by articles of a company or such company does not undertake multiple businesses.

Regulation 17(1B) of the Securities and Exchange Board of India (SEBI) (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations) specifies that the chairperson of the board of top 500 equity-listed companies would be a non-executive director and not be related to the MD or CEO in accordance with the definition of relative as per the 2013 Act. This requirement would not be applicable to listed companies that do not have any identifiable promoters as per the shareholding patterns filed with stock exchanges. This regulation was to be made effective from 1 April 2020.

SEBI, through its notification dated 10 January 2020, deferred the implementation of the provision relating to separation of the roles of non-executive chairperson and MD/CEO by two years, i.e., 1 April 2022.

Impact

SEBI's thought process in mandating the separation of the roles of chairperson (i.e., the leader of the board) and MD/CEO (i.e., the leader of the management) recognizes that the board supervises the management and reports to the shareholders. The separation would provide a balanced governance structure, which eliminated a potential conflict of interest if one person occupies both the CEO and chairperson roles, especially for the larger promoter-led companies.

This regulatory requirement shall require companies to start looking at long-term segregation of responsibilities and succession planning effectively, especially in promoter-run companies. The deferment of implementation of the requirement on separation of roles of chairperson and MD/CEO up to 1 April 2022 provides additional time to companies to complete and implement their action plans for these important positions.

9. Implementation of timelines for Kotak Committee's recommendations

The Securities and Exchange Board of India (SEBI), on 9 May 2018, had released the SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018 (SEBI (LODR Amendment) Regulations, 2018 or Corporate Governance Amendments or the amendments), in order to adopt and give effect to several recommendations that the SEBI Committee had on corporate governance.

SEBI aimed to put into effect these Corporate Governance Amendments in a phased timeline from 1 October 2018 to 1 April 2020, so that the companies are able to adjust to new governance requirements as well as overcome any implementation challenges.

The following are key amendments that companies need to comply to during the last financial year latest by 1 April 2020:

	Amendment	Timeline
Composition of board	The amendments propose to increase the minimum number of Board of Directors to six as against three under the Companies Act, 2013.	Applicable to top 1000 listed companies by 1 April 2019 and to top 2000 listed companies by 1 April 2020
Gender diversity on the board	The amendments require at least one independent woman director on the board. Earlier, the Companies Act, 2013 and SEBI (LODR) Regulations 2018 required at least one-woman director to be on the board of listed entities who may be either an independent or a non-independent director.	Applicable to top 500 listed companies by 1 April 2019 and to top 1000 listed companies by 1 April 2020
Maximum number of directorships	Directorship as independent director is restricted to seven listed entities, except where a person who is serving as a whole-time director/managing director in any listed entity, shall serve as an independent director in not more than three listed entities.	By 1 April 2020
Quorum of board meeting	The Companies Act requires a quorum of one-third of the total strength of the Board of Directors or two directors, whichever is higher, for every board meeting. SEBI (LODR) Regulations, 2018 does not prescribe any quorum for meetings of the Board of Directors. The amendments require the quorum for every meeting of the Board of Directors of the listed entity to be 1/3 of its total strength or three directors, whichever is higher including at least one independent director. The participation of the directors by video conferencing or by other audio-visual means shall also be counted for the purposes of such quorum.	Applicable to top 1000 listed companies by 1 April 2019 and to top 2000 listed companies by 1 April 2020
Disclosure of expertise and skills of directors	A list of core skills/expertise/competencies identified by the board as required in the context of its business(es) and sector(s) for an efficient functioning of directors is required to be disclosed.	Disclosed in annual report for year ended 31 March 2020

	Amendment	Timeline
Declaration of independent director	The amendments introduce a new requirement for independent directors to submit a declaration stating that they meet the criteria of independence as specified in the amended definition of an "Independent Director", followed with a confirmation that they are not aware of any circumstance or situation, which exists or may be reasonably anticipated, that could impair or impact their ability to discharge duties with objective independent judgements and without any external influence.	Applicable from 1 April 2019
Resignation of independent director(s)	The amendments introduce a new requirement for the listed entities to disclose to the stock exchanges and also as a part of the Corporate Governance Report, the detailed reasons for resignation of the independent directors before the expiry of their tenure along with a confirmation given by such director(s) that there are no other material reasons other than those provided.	Applicable from 1 April 2019
Board committees	Enhanced roles of audit committee, risk management committee, nomination and remuneration committee and stakeholders' relationship committee.	Applicable from 1 April 2019
Governance of group company	To keep a track and manage operations at the group level, it is important for the boards to ensure that good governance trickles down to the entire structure. These amendments provide for better transparency of the governance levels of downstream investee entities of the listed entity and to improve the monitoring of the listed entity at a consolidated level. In addition, companies will also need to have an effective governance program in place even for its subsidiaries, such that the Company aligns with the governance program at the listed parent entity's board, which results in same values, ethics, controls and processes being reflected across the group. Appointing at least one independent director to the board of all unlisted material subsidiary is a step in this direction to build an effective oversight role.	Applicable from 1 April 2019
Quarterly financial statements	The amendments remove the option given in every financial year to the listed entity to opt for submission of consolidated financial results on a quarterly/year-to-date basis and rather, make it mandatory to submit consolidated financial results on a quarterly/year-to-date basis.	Applicable from 1 April 2019
Cash flow submission	The amendments introduce a requirement that the listed entity should submit, by way of a note, a statement of cash flows for the half-year as part of its standalone and consolidated financial results for the half-year.	Applicable from 1 April 2019
Audit/limited review of quarterly consolidated financial results	The amendments introduce a requirement for the listed entity to ensure, for the purposes of quarterly consolidated financial results, that at least 80% of each of the consolidated revenue, assets and profits respectively shall have been subject to audit or in case of unaudited results, subjected to limited review.	Applicable from 1 April 2019
Searchable formats of disclosures	The amendments introduce the requirement for the listed entity to make disclosures: <ul style="list-style-type: none"> ▶ To stock exchanges, in eXtensible Business Reporting Language (XBRL) format, in accordance with the guidelines specified by the stock exchanges from time to time; ▶ To stock exchanges and on the entity's website in a format that allows users to find relevant information easily through a searching tool. The above requirement does not override any statutory requirements to make disclosures in formats which may not be searchable, such as copies of scanned documents.	Applicable from 9 May 2019
Business responsibility report	Disclosure of adoption of responsible business practices by a listed company to all its stakeholders.	Top 1000 listed companies by market capitalization, applicable for year ending March 2020.

The above table does not list amendments for which the date of compliance was before 1 April 2019.

Impact

The SEBI's step has been taken as a welcome move based on the recommendations of the Kotak Committee. The steps are being implemented through amendments to the Listing Regulations and other related guidance that SEBI issued through a circular. This will go a long way in improving the corporate governance practice in the Indian listed companies. Many of the amendments were applicable from 1 April 2019 and companies have already complied with the same. However, considering the nature of amendments there are being brought out, companies have been facing hardships in terms of preparedness and disclosure requirements.

10. The Finance Act, 2020

Key requirements

On 20 September 2019, the Taxation Laws (Amendment) Ordinance, 2019 was issued to make certain amendments to the provisions of the Income-tax Act, 1961 (IT Act) and the Finance (No.2) Act, 2019 with effect from FY 2019-20.

The key amendments relate to the following:

1. Tax concession for domestic companies
2. Tax concession for new domestic manufacturing companies
3. Reduction in Minimum Alternate Tax (MAT) rate and
4. Buy-back provisions

On 11 December 2019, the ordinance received the President's assent.

The following concessional tax rates were announced:

- a) Existing domestic companies have been provided an option to pay tax at a concessional tax rate (CTR) of

22% with the effective tax rate being 25.17% inclusive of surcharge and cess. The decision to opt for the concessional rates can be taken in any year. Companies opting for concessional tax rate would not be required to pay MAT.

- b) New domestic manufacturing companies incorporated on or after 1 October 2019 and commencing their production before 31 March 2023 would have the option to pay tax at 15% with effective tax rate being 17.16% inclusive of surcharge and cess. The decision to opt for the concessional rates need to be taken in the first year of filing the return. Companies opting for concessional tax rate would not be required to pay MAT.

The option once exercised cannot be withdrawn.

However, the reduced tax rates come with consequential surrender of specified deductions/ incentives. Companies that do not opt for the concessional tax rates will continue to enjoy the benefit of such specified deductions/ incentives, and where applicable, be subject to MAT at 15%.

Impact

A) Treatment of MAT credit

Section 115JB of the IT Act relating to MAT will no longer be applicable to companies that opt for concessional tax rate regime. As per the clarification by the government, MAT credit which was available earlier, will no longer be available. Due to this, the existing MAT credit will not meet the definition of an asset for the companies opting for concession tax rate. Companies may have to derecognize/ reverse DTA recognized in respect of MAT credit.

B) Re-measurement of deferred tax

Changes in tax rates will require companies to remeasure their existing deferred tax assets and liabilities. All re-measurement impact may not be

accounted for in the profit and loss account (P&L). Companies need to remeasure existing deferred tax assets and liabilities and apply backward tracing to attribute the impact to

- i) Profit or loss
- ii) Other comprehensive income
- iii) Equity

In scenarios where it is difficult to determine the amount that should be recorded outside P&L, for e.g., tax effect on compound financial instruments, companies may use a reasonable pro-rata allocation method.

C) Impact on deferred tax on Ind AS 116

The companies which have adopted Ind AS 116 from 1 April 2019, the impact on account of modified retrospective or full retrospective approach would have been taken to retained earnings as at 1 April 2019. The companies would have accounted for tax impact on such adjustment to retained earnings as at 1 April 2019. Tax impact would be calculated using tax rates enacted and applicable as at 1 April 2019.



It is imperative for companies to evaluate the impact of tax rate changes on financial statements as it would have significant impact on effective tax rate for companies.

Jalpa Sonchhatra

Director, Financial Accounting Advisory Services (FAAS), EY India

The companies would now need to remeasure deferred tax assets and liabilities arising on such ROU assets and lease liabilities using revised tax rates (if company opts for Concessional Tax Rate CTR). Remeasurement should be accounted for in profit and loss account (i.e., relating to Deferred Tax Assets (DTA)/ Deferred Tax Liabilities (DTL) accounted on Ind AS 116 adjustment as at 1 April 2019).

D) Business combination that occurred prior to enactment date

In cases where business combinations have been accounted using provisional purchase price allocation, new information about the facts and circumstances that existed at the acquisition date for tax positions may result in adjustment in goodwill during business combination period during measurement period.

However, where provisional purchase price allocation is done prior to announcement of such new tax regime, no adjustment in deferred tax should be adjusted in goodwill during the measurement period as the fact did not exist on the acquisition date. Hence, any change in deferred taxes should be recognized in profit and loss account.

Abolishment of Dividend Distribution Tax

Key requirements

Dividend Distribution Tax (DDT) was applicable to all Indian companies on distribution of dividends at a rate of 20.56%. This was proposed to be abolished by the Union Budget 2020-2021. Non-resident shareholders will now be subject to be taxed at 20% on the dividend income under the domestic tax law.

Impact

Ind AS 12 requires companies to recognize deferred tax liability on undistributed profits of subsidiaries, branches, associates and joint ventures in cases where the parent company does not control the dividend policy of the subsidiary. Further, the tax laws earlier allowed credit of any DDT paid by the subsidiary on such distributions when the parent distributed dividend to its shareholder. Hence, the deferred tax was usually created at the rate of DDT.

In spite of abolishment of DDT, companies will be required to create deferred tax liability in cases where the parent does not control the dividend policy of the subsidiary, associate and joint venture. However, now the companies may have to create the deferred tax in respect of undistributed profits of subsidiaries at the rate at which the dividend shall be taxable in the hands of the parent.

11. Valuation Standards issued by ICAI

Key requirements

The ICAI recognized the need to have the consistent, uniform and transparent valuation policies and harmonize the diverse practices in use in India. In this regard, ICAI formed the Valuation Standards Board (VSB) in February 2017 with an objective to identify and suggest the areas in which valuation standards need to be developed and formulated.

The VSB comprises of participation from various interest groups, central government nominees, representatives of industry associations, Central Board of Direct Taxes, Reserve Bank of India, Comptroller and Auditor General, Insurance Regulatory and Development Authority of India, SEBI and other academicians.

It was created to standardize the various principles, practices and procedures followed by registered valuers and other

valuation professionals in valuation of assets, liabilities or a business. These standards are mandatory to follow. They provide a benchmark to the professionals to ensure uniformity in approach and quality of valuation output.

The standards cover various areas impacting financial statements like business valuation and intangible assets, including impairment and financial instruments. Further, the Framework for Preparation of Valuation Report in accordance with these standards lays down various qualitative characteristics of the valuation report like relevance, reliability and understandability among others.

The valuer is responsible for the preparation of valuation report in compliance with the valuation standards and for adequate disclosure of information that supports the conclusion

Impact

There is a need for companies to ensure that they obtain valuation reports that are compliant with the requirements of the mandatory valuation standards for various areas requiring valuation.

12. Impact of Coronavirus outbreak

With the outbreak of Coronavirus and it being declared pandemic, many companies have been asked to limit or suspend their business operations and to implement travel restrictions and quarantine measures. These measures and policies have significantly disrupted (and are expected to disrupt) the activities of many companies. As the outbreak continues to progress, it is challenging at this juncture, to predict the full extent and duration of its business and economic impact. Companies may need to consider the following while evaluating the financial and economic impact of the outbreak:



The impact of Coronavirus is expected to be significant and will have implications in all aspects of the organization. It will be critical for organizations to assess the impact on their financial statement.

Sandip Khetan

Partner and National Leader,
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a) Going Concern

In assessing whether the going concern assumption is appropriate, the Ind AS 1 requires that all available information about the future, which is at least, but not limited to, 12 months from the end of the reporting period, should be taken into account.

When assessing the ability of the companies to continue as going concern, where relevant, they are required to consider the existing and anticipated effects of the outbreak on its activities in its assessment of the appropriateness of the use of the going concern basis. Given the unpredictability of the potential impact of the outbreak, there may be material uncertainties that are likely to cast significant doubts on the company's ability to operate under the going concern basis.

Significant judgement and continual updates to the assessments up to the date of issuance of the financial statements may be required given the evolving nature of the outbreak and the uncertainties involved.

b) Fair Value Measurement

Ind AS 113 Fair Value Measurement specifies that fair value measurement is a measurement date specific exit price estimate based on assumptions (including those about risks) that market participants would make under current market conditions. The information available to the market at the reporting date is relevant in determination of fair value.

Accordingly, companies should consider all the relevant information about the outbreak and known to the market participants at the reporting date in order to determine the fair value at reporting date.

c) Expected credit loss assessment

Ind AS 109 Financial Instruments requires a company to incorporate reasonable and supportable information about past events, current conditions and the forecast of future economic conditions while assessing expected credit losses (ECL) for financial assets not measured at fair value through profit or loss.

The outturn of events post the outbreak and all forecasted information in this regard needs to be considered while assessing the expected credit loss. The implications could vary depending upon company-specific situation and its methodology in assessing ECL.

The companies should consider disclosing qualitative and quantitative information to help users of financial statements to understand the effect of credit risk on the amount, timing and uncertainty of future cash flows. This includes use of inputs, assumptions and estimation techniques, and how forward-looking information has been incorporated.

d) Impairment testing

An asset is impaired when a company is not able to recover its carrying value, either by using it or selling it. Companies estimate the recoverable amount, i.e., the higher of the fair value less costs of disposal (FVLCD) and the value in use (VIU). The value in use is defined as the present value of the future cash flows expected to be derived from an asset or cash-generating unit.

The forecasted cash flows should reflect the management's best estimate of the economic conditions that may exist over the remaining useful life of the asset and should consider any impacts due to Coronavirus. Companies are required to determine whether the outbreak is an impairment indicator at the reporting date, which results in an impairment assessment.

Also, the more the current environment is uncertain, the more important it is for the company to provide detailed disclosure of the assumptions taken, the evidence they are based on and the impact of a change in the key assumptions

e) Other disclosure requirements

Ind AS 1 requires disclosure of information about the assumptions concerning the future, and in estimating the uncertainties at the end of the reporting period, that may have a result in material adjustment to the carrying amounts of assets and liabilities, such as noncurrent assets subject to impairment, within the next financial year (with the exception of assets and liabilities measured at fair value based on recently-observed market prices). The disclosures are required to be presented in a manner that helps users of financial statements to understand the judgements that management makes about the future and about other key sources of estimation uncertainty. The nature and extent of the information provided may vary according to the nature of the assumption and other circumstances.

In relation to the assumptions and uncertainties, the outbreak has certainly added additional risks that may require material adjustments in the carrying amounts of assets and liabilities within the next financial year.

Therefore, companies should carefully consider whether additional disclosures are necessary for users of financial statements to understand the judgement applied in the financial statements. Such disclosure may include, for a financial statement, an item with a carrying amount that is more volatile in response to the outbreak, a sensitivity of carrying amounts to the methods, assumptions and estimates underlying their calculation.

Annexure 1: Illustrative Ind AS 116 disclosures

Note XX: leases

Group as lessee

Nature of company's leasing activities to be described and restrictions or covenants imposed by leases to be disclosed. Further, it is essential to disclose whether short term and low value lease exemption is availed

	Building	Fixture and furniture	Equipments	Others	Total
	INR	INR	INR	INR	INR
Opening net carrying balance					
Adoption of IFRS 16 Leases					
Additions					
Depreciation					
Impairment					
Exchange differences					
Closing net carrying balance	XXXX	XXXX	XXXX	XXXX	XXXX

Lease liabilities: other financial liability	As at 31 March 2020
	INR
Current	
Lease liabilities	XXXX
Non-current	
Lease liabilities	XXXX
Total lease liabilities	XXXX

Maturity analysis of contractual undiscounted cash flow	Less than 1 year	1 - 5 years	Equipments	Others	Total
	INR	INR	INR	INR	INR
XXXX					
XXXX					
XXXX					
XXXX					
Total undiscounted lease liabilities	XXXX	XXXX	XXXX	XXXX	XXXX

Some of the leases contain extension and termination options. Such options are considered while determining the lease term only if extension or non-termination can be assumed with reasonable certainty. On this basis, there were no such amounts included in the measurement of lease liabilities as at 31 March 2020.

Statement of Profit and Loss

Amounts recognized in the Statement of Profit and Loss	2019-2020
	INR
Other income	
Operating lease income	XX
General and administrative expenses	
Short-term lease rent expense	
Low value asset lease rent expense	
Variable lease rent expense	
Other lease expense (additional cost)	
Depreciation and impairment losses	
Depreciation of ROU lease asset	
Impairment losses of ROU lease asset	
Finance cost	
Interest expense on lease liability	XX
Currency translation gains on lease liability	XX
Currency translation losses on lease liability	XX

Balance sheet

ICAI has proposed following amendments in Schedule III to align the same with Ind AS 116:

- In the format of balance sheet, a separate line item to be added as 'Lease Liabilities' under the sub-head Financial Liabilities (under both current and non-current liabilities)
- Also, from existing format line items 'Long term maturities of finance lease obligations' under non-current liabilities and 'Current maturities of finance lease obligations' under current liabilities to be deleted.

The above amendments have not yet been notified.

Statement of Cash Flows

Amount recognized in statement of cash flow	
Total cash outflow for leases	XX

Lease commitments for short-term leases

Companies are required to disclose the nature and amount of lease commitments for leases accounted as short-term lease to the extent that their committed portfolio is dissimilar to the portfolio that is already included in the short-term lease expense disclosure.

Future cash outflows to which the company is potentially exposed and not reflected in measurement of lease liabilities

Companies should include qualitative and quantitative information regarding their leasing activities which are necessary to meet the disclosure objective. This may include but is not limited to the following:

- Variable lease payments
- Extension options and termination options
- Residual value guarantees
- Leases not yet commenced to which the companies are committed

Transition disclosure notes

1. Adoption of a new accounting standard on Leases: Ind AS 116

The company, for instance, has adopted the new standard, Ind AS 116 Leases with effect from 1 April 2019 using the modified retrospective approach as per para C8 (c)(i) of Ind AS 116. The company has taken the cumulative impact of applying the standard to retained earnings as on the date of initial application. Accordingly, the company has not restated the comparative information.

On transition, the adoption of the new standard resulted in recognition of ROU asset of INRXXX, and a lease liability of INRXXX. The cumulative effect of applying the standard resulted in INRXXX being debited to retained earnings, net of taxes (including the impact of deferred tax created of INRXXX).

In statement of profit and loss for the current period, the nature of expenses in respect of operating leases has changed from lease rent in previous periods to depreciation cost for the ROU asset and finance cost for interest accrued on lease liability.

In the context of initial application, the company has exercised the option – not to apply the new recognition requirements to short-term leases and to leases of low-value asset.

2. The following table presents the reconciliation of lease liability:

	As at 1 April 2019
	₹
Off-balance sheet lease obligations as of 31 March 2019	XXX
Current leases with lease term of 12 months or less (short-term leases)	XX
Leases of low value assets (low-value leases)	XX
Variable lease payments	XX
Others	XX
Operating lease obligations as of 1 April 2019 (gross without discounting)	XXX
Effect from discounting at the incremental borrowing rate as at 1 April 2019	(XX)
Lease liabilities as at 1 April 2019	XXX
Non-lease components (if any) (net of discount)	XX
Lease liabilities due to initial application of Ind AS 116 as at 01 April 2019	XXX
Lease liabilities from finance leases as at 01 April 2019	XX
Total lease liabilities as of 01 April 2019	XXX

The lease liabilities were discounted using the incremental borrowing rate of the company as at 1 April 2019. The weighted average discount rate used for recognition of lease liabilities was XX%

3. The following are the practical expedients availed by the company on transition:

The company has to disclose all the practical expedients availed from para C10 of Ind AS 116.



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