

Ind AS Transition Facilitation Group (ITFG) Clarification Bulletin 7

‘Ind AS Transition Facilitation Group’ (ITFG) of Ind AS (IFRS) Implementation Committee has been constituted for providing clarifications on timely basis on various issues related to the applicability and /or implementation of Ind AS under the Companies (Indian Accounting Standards) Rules, 2015, raised by preparers, users and other stakeholders.

Ind AS Transition Facilitation Group (ITFG) considered some issues received from members and decided to issue following clarifications¹ on March 30, 2017:

Issue 1: Company ABC Ltd. is required to mandatorily comply with Ind AS from financial year 2016-17. It had entered into a foreign currency loan agreement for USD 100 million on March 31, 2010 for construction of its property, plant and equipment (PPE). It had drawn USD 70 million upto March 31, 2016. The company had availed the option given under paragraph 46/46A of AS 11, *The Effects of Changes in Foreign Exchange Rates* notified under the Companies (Accounting Standards) Rules, 2006. Accordingly, exchange gain/loss on such foreign currency loan had been added to or deducted from the cost of PPE. The Company has opted for the exemption given under paragraph D13AA of Ind AS 101, *First-time Adoption of Indian Accounting Standards*.

The balance amount of USD 30 million will be drawn after 1st April, 2016. Whether the exemption under paragraph D13AA is also available for the balance loan amount of USD 30 million to be drawn after 1st April, 2016?

Response: Paragraph D13AA of Ind AS 101 states as follows:

“A first-time adopter may continue the policy adopted for accounting for exchange differences arising from translation of long-term foreign currency monetary items recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP.”

As stated above, it may be noted that the exemption under paragraph D13AA is available only for the exchange differences arising from translation of long-term foreign currency monetary items recognised in the financial statements immediately before the beginning of the first Ind AS financial reporting period.

Accordingly, in the given case, the exemption under paragraph D13AA for the exchange gain/loss on foreign currency loan amount of USD 70 million is available to ABC Ltd. However, it cannot avail the exemption under paragraph D13AA for the exchange gain/loss on balance amount of loan, i.e., USD 30 million, as the same will be drawn after 1st April, 2016.

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

Issue 2: Company X, which is incorporated in India is the wholly-owned subsidiary of Company Y. In accordance with the principles of Ind AS 21 *The Effects of Changes in Foreign Exchange Rates*, Company X has ascertained its functional currency to be USD. Company X has subsidiaries and joint ventures outside India and prepares both standalone as well as consolidated financial statements. The functional currency of the parent company, i.e. Company Y continues to be INR. Company Y will require Company X to provide its annual consolidated financial statements presented in INR for consolidation and reporting at ultimate parent level.

Whether Company X would present its annual financial statements as per Ind AS in its functional currency (i.e. USD) or in the functional currency of the parent company (INR)? Further, whether statutory auditors of Company X will provide their audit report on financial statements prepared in INR or financial statements prepared in USD?

Response:

As per paragraph 17 of Ind AS 21, *“In preparing financial statements, each entity—whether a stand-alone entity, an entity with foreign operations (such as a parent) or a foreign operation (such as a subsidiary or branch)—determines its functional currency in accordance with paragraphs 9–14. The entity translates foreign currency items into its functional currency and reports the effects of such translation in accordance with paragraphs 20–37 and 50.”*

Paragraph 21 of Ind AS 21 states that, *“A foreign currency transaction shall be recorded, on initial recognition in the functional currency, by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of the transaction.”*

In accordance with the above, it may be noted that each entity is required to determine its functional currency in accordance with Ind AS 21 and is required to translate foreign currency items into functional currency.

Further, Paragraph 18 of Ind AS 21 states as follows:

“Many reporting entities comprise a number of individual entities (e.g a group is made up of a parent and one or more subsidiaries). Various types of entities, whether members of a group or otherwise, may have investments in associates or joint arrangements. They may also have branches. It is necessary for the results and financial position of each individual entity included in the reporting entity to be translated into the currency in which the reporting entity presents its financial statements. This Standard permits the presentation currency of a reporting entity to be any currency (or currencies). The results and financial position of any individual entity within the reporting entity whose functional currency differs from the presentation currency are translated in accordance with paragraphs 38–50.”

Paragraphs 38 & 39 of Ind AS 21 are stated below:

“38 An entity may present its financial statements in any currency (or currencies). If the presentation currency differs from the entity’s functional currency, it translates its results and financial position into the presentation currency. For example, when a group contains individual entities with different functional currencies, the results and financial position of each entity are expressed in a common currency so that consolidated financial statements may be presented.

39 The results and financial position of an entity whose functional currency is not the currency of a hyperinflationary economy shall be translated into a different presentation currency using the following procedures:

(a) assets and liabilities for each balance sheet presented (ie including comparatives) shall be translated at the closing rate at the date of that balance sheet;

(b) income and expenses for each statement of profit and loss presented (ie including comparatives) shall be translated at exchange rates at the dates of the transactions; and

(c) all resulting exchange differences shall be recognised in other comprehensive income.”

In accordance with the above paragraphs, it may be noted that entities within a group may have different functional currencies. Further, as Ind AS does not prohibit the use of any currency as presentation currency, an entity may present its financial statements in any currency by applying the translation procedures from functional to presentation currency as stated above.

Accordingly, in the given case, if Company X is statutorily required to present its financial statements in INR, which is different from its functional currency, i.e. USD, then it may do so by choosing the INR as presentation currency and prepare and present its financial statements by applying the provisions of paragraphs 38 and 39 of Ind AS 21.

As Company X is statutorily required to present its financial statements in INR, the auditor of Company X will be required to give audit report on financial statements prepared in INR.

Issue 3: Company X had opted the option available under paragraph 46/46A of AS 11, *The Effects of Changes in Foreign Exchange Rates* notified under the Companies (Accounting Standards) Rules, 2006. Accordingly, exchange gain/loss on foreign currency borrowings had been added to or deducted from the cost of property, plant and equipment (PPE).

Company X is a first-time adopter of Ind AS and has availed the exemption given under paragraph D7AA of Ind AS 101 *First-time Adoption of Indian Accounting Standards*, however, it wishes to retrospectively reverse the effect of paragraph 46/46A from its PPE. Whether Company X is allowed to do so?

Response: Paragraph D7AA of Ind AS 101 states as follows:

*“Where there is no change in its functional currency on the date of transition to Ind ASs, a first-time adopter to Ind ASs may elect to continue with the carrying value for all of its property, plant and equipment as recognised in the financial statements as at the date of transition to Ind ASs, measured as per the previous GAAP and use that as its deemed cost as at the date of transition after making necessary adjustments in accordance with paragraph D21 and D21A, of this Ind AS. For this purpose, if the financial statements are consolidated financial statements, the previous GAAP amount of the subsidiary shall be that amount used in preparing and presenting consolidated financial statements. Where a subsidiary was not consolidated under previous GAAP, the amount required to be reported by the subsidiary as per previous GAAP in its individual financial statements shall be the previous GAAP amount. If an entity avails the option under this paragraph, **no further adjustments to the deemed cost of the property, plant and equipment** so determined in the opening balance sheet shall be made for transition adjustments that might arise from the application of other Ind ASs. This option can also be availed for intangible assets covered by Ind AS 38, Intangible Assets and investment property covered by Ind AS 40, Investment Property.”*

In accordance with the above, it may be noted that when an entity opts for deemed cost exemption under paragraph D7AA of Ind AS 101 then it cannot make any adjustments to the carrying amount of PPE. Thus, once the entity avails the exemption provided in paragraph D7AA, it will be carrying forward the previous GAAP carrying amount for all of its property, plant and equipment.

Accordingly, in the given case, Company X cannot reverse the impact of paragraph 46A of AS 11 from its PPE as it has opted for the deemed cost exemption provided under D7AA.

Issue 4: ABC Ltd. is a first time adopter of Ind AS. It has been exercising the option provided in paragraph 46/46A of AS 11, *The Effects of Changes in Foreign Exchange Rates* notified under the Companies (Accounting Standards) Rules, 2006 and intends to continue the same accounting policy in accordance with paragraph D13AA of Ind AS 101, *First-time Adoption of Indian Accounting Standards* . The entity used to apply the provisions of paragraph of 46/46A of AS 11 to long-term forward exchange contracts as such contracts were also covered by paragraph 36 of AS 11. Whether ABC Ltd. can continue the accounting policy for exchanges differences to long term forward exchange contracts?

Response:

Paragraph D13AA of Ind AS 101 states as follows:

“A first-time adopter may continue the policy adopted for accounting for exchange differences arising from translation of long-term foreign currency monetary items recognised

in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP.”

The exemption in D13AA relates to accounting for foreign exchange differences on long term foreign currency monetary items recognised in the financial statement only, and it does not relate to the accounting for long term forward exchange contracts (as these contracts are not within scope of Ind AS 21 and are treated in accordance with Ind AS 109). Therefore, an entity cannot continue to apply the provisions of paragraph 46/46A of AS 11 to long-term forward exchange contracts by virtue of availing exemption given in paragraph D13AA of Ind AS 101.

Further, following paragraphs of Ind AS 21 would be relevant when accounting for long term forward exchange contracts:

Paragraph 3 of Ind AS 21, *inter alia*, states that Ind AS 21 shall be applied in accounting for transactions and balances in foreign currencies, except for those derivative transactions and balances that are within the scope of Ind AS 109, *Financial Instruments*.

Paragraph 4 of Ind AS 21 states as follows:

“Ind AS 109 applies to many foreign currency derivatives and, accordingly, these are - excluded from the scope of this Standard. However, those foreign currency derivatives that are not within the scope of Ind AS 109 (e.g some foreign currency derivatives that are embedded in other contracts) are within the scope of this Standard. In addition, this Standard applies when an entity translates amounts relating to derivatives from its functional currency to its presentation currency.”

Long term forward exchange contracts generally meet the definition of ‘Derivatives’ which are within the scope of Ind AS 109, *Financial Instruments*. Therefore, ABC Ltd has to follow the accounting requirements of Ind AS 109 for accounting long term forward exchange contracts.

Issue 5: XYZ Ltd. has obtained a land from the government on a long- term lease basis which spans 99 years and above. At the end of the lease term, the lease could be extended for another term or the land could be returned to the government authority. Whether such land leases should be classified as finance lease or operating lease in the financial statements of XYZ Ltd. prepared in accordance with Ind AS?

Response:

Paragraph 4 of Ind AS 17, *Leases, inter alia*, provides as follows:

“A finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not be eventually be transferred.

An operating lease is a lease other than a finance lease.”

Further, paragraph 15A of Ind AS 17, states as follows:

“15A When a lease includes both land and buildings elements, an entity assesses the classification of each element as a finance or an operating lease separately in accordance with paragraphs 7–13. In determining whether the land element is an operating or a finance lease, an important consideration is that land normally has an indefinite economic life.”

Therefore, one important consideration for evaluating lease of land is that land has an indefinite economic life and it is expected that the value of land generally appreciates.

Paragraph 10 & 11 of Ind AS 17, *Leases* states as follows:

“10 Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are:

- (a) the lease transfers ownership of the asset to the lessee by the end of the lease term;*
- (b) the lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised;*
- (c) the lease term is for the major part of the economic life of the asset even if title is not transferred;*
- (d) at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and*
- (e) the leased assets are of such a specialised nature that only the lessee can use them without major modifications.*

11 Indicators of situations that individually or in combination could also lead to a lease being classified as a finance lease are:

- (a) if the lessee can cancel the lease, the lessor’s losses associated with the cancellation are borne by the lessee;*
- (b) gains or losses from the fluctuation in the fair value of the residual accrue to the lessee (for example, in the form of a rent rebate equalling most of the sales proceeds at the end of the lease); and*
- (c) the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.”*

In case of lease of land for 99 years and above, if it is likely that such leases meet the criteria that at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset then in this case, such lease will be classified as ‘finance lease’.

However, it may also be noted that land normally has an indefinite economic life. Where in substance there is no transfer of risks and rewards, it should be considered as an operating lease. Some of the indicators to consider in the overall context of whether there is transfer of

risks and rewards incidental to ownership include the lessee's ability to renew lease for another term at substantially below market rent, lessee's option to purchase at price significantly below fair value etc..

Accordingly, classification as operating or finance lease requires exercise of judgement based on evaluation of facts and circumstances in each case, while considering the indicators envisaged as above.

Issue 6: ABC Ltd. has declared dividend on a financial instrument (which has been classified as a liability in accordance with Ind AS 32, *Financial Instruments: Presentation*), after the end of the reporting period. Whether ABC Ltd. is required to accrue such dividends in the financial statements for the year even if it is declared after the end of the reporting period?

Response:

Assuming ABC Ltd. has correctly classified the financial instrument as financial liability as per Ind AS 32, then it shall account for dividend in accordance with the following provisions of paragraph 35 of Ind AS 32:

“35 Interest, dividends, losses and gains relating to a financial instrument or a component that is a financial liability shall be recognised as income or expense in profit or loss. Distributions to holders of an equity instrument shall be recognised by the entity directly in equity. Transaction costs of an equity transaction shall be accounted for as a deduction from equity.”

Further, paragraph 12 of Ind AS 10 states that, *‘If an entity declares dividends to holders of equity instruments after the reporting period, the entity shall not recognise those dividends as a liability at the end of the reporting period.’*

It may also be noted that the above paragraph of Ind AS 10 applies only to those financial instruments which are classified as equity instruments. The payment of dividend/interest to financial instruments classified as liability accrues at the end of the reporting period even if it is paid or declared after the end of the reporting period. Accordingly, in the given case, ABC Ltd. is required to account for the dividend, even if it is declared after the end of the reporting period.

Further, accounting for dividend on financial instrument which is classified as financial liability is governed by classification of such instrument under Ind AS 109. If it is classified as subsequently measured at Amortised Cost, dividend will be accrued as part of interest expense recognised based on effective interest method.

Issue 7: A freehold land is held by PQR Ltd. which it expects to sell on a slump-sale basis and not individually. Whether PQR Ltd. is not required to recognise deferred tax

asset on such land on the basis that the same will be sold on a slump sale basis and hence a temporary difference would not exist. PQR Ltd. has entered into similar slump sale arrangements in the past.

Response: As per paragraph 5 of Ind AS 12, “*Temporary differences are differences between the carrying amount of an asset or liability in the balance sheet and its tax base. Temporary differences may be either:*

(a) taxable temporary differences, which are temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled; or

(b) deductible temporary differences, which are temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.

The tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes.”

Further paragraphs 15 and 24 of Ind AS 12, states as follows:

15 *A deferred tax liability shall be recognised for all taxable temporary differences, except to the extent that the deferred tax liability arises from:*

(a) the initial recognition of goodwill; or

(b) the initial recognition of an asset or liability in a transaction which:

(i) is not a business combination; and

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

However, for taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, a deferred tax liability shall be recognised in accordance with paragraph 39.

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

(a) is not a business combination; and

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

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

In view of the above provisions of Ind AS 12, it may be noted that deferred tax asset/liability is to be created for all deductible/taxable temporary differences, except in specified situations eg. if it arises from a transaction that affects neither accounting profit nor taxable profit (tax loss) at the time of the transaction (known as initial recognition exemption).

Paragraph 51 of Ind AS 12 further states that, *“The measurement of deferred tax liabilities and deferred tax assets shall reflect the tax consequences that would follow from the manner in which the entity expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.”*

In accordance with the above, it may be noted that creation of deferred tax is dependent upon the tax consequences that will follow on the basis of the expected manner of recovery or settlement of the asset/liability by the entity. The expectation of the entity at the end of the reporting period with regard to the manner of recovery or settlement of its assets and liabilities will require exercise of judgement based on evaluation of facts and circumstances in each case. It may be relevant to consider that there is substance to management’s expectation of the entity being able to recover the asset through slump sale or otherwise.

However, it is also important note the following principle of Ind AS 12:

Paragraph 51B of Ind AS 12 states that, *“If a deferred tax liability or deferred tax asset arises from a non-depreciable asset measured using the revaluation model in Ind AS 16, the measurement of the deferred tax liability or deferred tax asset shall reflect the tax consequences of recovering the carrying amount of the non-depreciable asset through sale, regardless of the basis of measuring the carrying amount of that asset. Accordingly, if the tax law specifies a tax rate applicable to the taxable amount derived from the sale of an asset that differs from the tax rate applicable to the taxable amount derived from using an asset, the former rate is applied in measuring the deferred tax liability or asset related to a non depreciable asset.”*

In accordance with the above, it may be noted that if a non-depreciable asset is measured using the revaluation model, then an entity is required to measure the DTA/DTL considering the tax consequences of recovering the carrying amount through sale.

In the given case PQR Ltd. will be required to evaluate facts and circumstances to assess whether the freehold land will be sold through slump sale. If it is concluded based on evaluation of facts that the land will be sold through slump sale, then the tax base of the land will be the same as the carrying amount of the land, as indexation benefit is not available in case of slump sale (as per Income Tax Act, 1961) and hence there will not be any temporary difference.

Issue 8: XYZ Ltd. is a holding company of ABC Ltd. and owns 60% voting share of ABC Ltd. Apart of equity investments, XYZ Ltd. has investment in debentures of

subsidiary company. Whether such an investment in debenture of subsidiary company would be covered under the scope of paragraph 10 of Ind AS 27, *Separate Financial Statements* and exemptions provided under D15 of Ind AS 101, *First-time Adoption of Indian Accounting Standards*.

Response:

According to paragraph 2.1(a) of Ind AS 109, the standard is not applicable to those interests in subsidiaries, associates and joint ventures that are accounted for in accordance with Ind AS 110, *Consolidated Financial Statements*, Ind AS 27, *Separate Financial Statements* or Ind AS 28, *Investments in Associates and Joint Ventures*.

However, in some cases, Ind AS 110, Ind AS 27 or Ind AS 28 require or permit an entity to account for an interest in a subsidiary, associate or joint venture in accordance with some or all of the requirements of this Standard i.e. Ind AS 109.

Paragraph 10 of Ind AS 27, *Separate Financial Statements*, *inter alia*, states as follows:

“10 When an entity prepares separate financial statements, it shall account for investments in subsidiaries, joint ventures and associates either:
(a) at cost, or
(b) in accordance with Ind AS 109.”

Further, paragraph D15 of Ind AS 101 provides exemption with regard to investments in subsidiaries, joint ventures and associates.

Paragraph D15 of Ind AS states as follows:

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

- (a) cost determined in accordance with Ind AS 27; or*
- (b) deemed cost. The deemed cost of such an investment shall be its:*
 - (i) fair value at the entity’s date of transition to Ind ASs in its separate financial statements; or*
 - (ii) previous GAAP carrying amount at that date.*

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

The Company needs to assess the terms of the debentures to determine whether the instrument can be considered as an investment in subsidiary as per Ind AS 27 or a financial asset as per Ind AS 109. If the debentures meet the definition of equity as per Ind AS 32 from the issuer's perspective (i.e. subsidiary), then it can be considered to be part of parent's investment in subsidiary and hence accounted for under Ind AS 27. However, where the instrument fails to meet the definition of equity from issuer's perspective (i.e. a liability of the subsidiary), it shall be classified as a financial asset and accounted for under Ind AS 109.

Investments covered by Ind AS 110 are those interests that give an entity right to control over the other entity, which are normally in the form of equity investments. An entity may have other investments commonly referred as long term investments which are not excluded from the scope of Ind AS 109.

Accordingly, in the given case, presuming that investment in debentures is not within the scope of Ind AS 110, it will not be covered under Ind AS 27 and therefore, should be accounted as financial asset under Ind AS 109.

Issue 9: A Ltd. is a first-time adopter of Ind AS from financial year 2016-17. It had entered into a service concession arrangement with government in respect of toll roads in the year 2014. Paragraph 7AA of Ind AS 38, *Intangible Assets* read with paragraph D22 of Ind AS 101, *First-time Adoption of Indian Accounting Standards* permits revenue based amortisation for the intangible assets arising from service concession arrangements in respect of toll roads recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS reporting period. As on 1st April 2016, the construction of toll road is in progress. Can A Ltd. avail the above exemption in respect of toll roads under construction/development as on 1st April, 2016.

Response: Paragraph D22 of Ind AS 101, *inter alia*, states as follows:

“D22 A first-time adopter may apply the following provisions while applying the Appendix A to Ind AS 11:

- (i) Subject to paragraph (ii), changes in accounting policies are accounted for in accordance with Ind AS 8, i.e. retrospectively, except for the policy adopted for amortization of intangible assets arising from service concession arrangements related to toll roads recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP.....”*

Further, paragraph 7AA of Ind AS 38, *Intangible Assets*, states as follows:

“7AA The amortisation method specified in this Standard does not apply to an entity that opts to amortise the intangible assets arising from service concession arrangements in respect of toll roads recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS reporting period as per the exception given in paragraph D22 of Appendix D to Ind AS 101.”

In accordance with the above, it may be noted that the exemption can be availed in respect of intangible assets arising from service concession arrangements in respect of toll roads recognised in the financial statements before the beginning of first Ind AS reporting period. In the given case, A Ltd. cannot avail the exemption because the intangible asset is in progress and the same have has not been recognised before 1st April, 2016 and amortisation has not begun.
