<u>Ind AS Technical Facilitation Group Clarification Bulletin 18</u>

Ind AS Technical Facilitation Group' (ITFG) of Ind AS Implementation Group 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, and other amendments finalised and notified till March 2018, raised by preparers, users and other stakeholders. Ind AS Technical Facilitation Group (ITFG) considered some issues received from members and decided to issue following clarifications[1] on February 07, 2019:

Issue 1: ABC Ltd. is a first time adopter of Ind ASs and its first Ind AS reporting period is financial year 2018-19. ABC Ltd. 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 to follow the same accounting policy in accordance with paragraph D13AA of Ind AS 101, *First-time Adoption of Indian Accounting Standards*.

As per circular no. 25/2012 dated August 9, 2012 issued by the Ministry of Corporate Affairs (MCA), paragraph 6 of Accounting Standard (AS) 11 and paragraph 4(e) of AS 16 shall not apply to a company that opts to apply paragraph 46A of AS 11.

Whether the words "may continue the policy adopted for accounting for exchange differences" appearing in paragraph D13AA of Ind AS 101 include the policy adopted for accounting for exchange differences that qualify as borrowing costs as per paragraph 6(e) of Ind AS 23?

Response: Paragraph D13AA of Ind AS 101, *First-time Adoption of Indian Accounting Standards* 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*."

Paragraph 46A of AS 11, *The Effects of Changes in Foreign Exchange Rates*, provides an irrevocable option to a company to account for exchange differences relating to long-term foreign currency monetary items in the manner laid down in paragraph 46A rather than applying the general requirements of the standard relating to treatment of exchange difference. The said paragraph was inserted into AS 11 in December 2011 and is effective in

[1] Clarifications given or views expressed by the Ind AS Technical Facilitation Group (ITFG) represent the views of the ITFG and are not necessarily the views of the Ind AS Implementation Group 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 this Bulletin is February 07, 2019. The clarification must, therefore, be read in the light of any amendments and/or other developments subsequent to the issuance of clarifications by the ITFG. The clarifications given are only for the accounting purpose. The commercial substance of the transaction and other legal and regulatory aspects has not been considered and may have to be evaluated on case to case basis.

respect of accounting periods commencing on or after the April 1, 2011. The application of paragraph 46A by a company requires compliance with certain specified conditions.

Paragraph 6 of AS 11 scopes out exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs (under paragraph 4(e) of AS 16, *Borrowing Costs*. As a consequence of insertion of paragraph 46A into AS 11, the circular issued by the Ministry of Corporate Affairs on August 9 2012 clarified that "Para 6 of Accounting Standard- 11 and Para 4(e) of the Accounting Standard-16 shall not apply to a company which is applying clause 46-A of Accounting Standard -11."

Thus, the effect of the circular is that a company that opts to apply paragraph 46A of AS 11 is required to apply the said paragraph 46A (and not AS 16) to those exchange differences also that arise from long-term foreign currency borrowings and would be regarded as an adjustment to interest costs under paragraph 4(e) of AS 16.

Paragraph D13AA of Ind AS 101 allows an entity to **"**continue the policy adopted for accounting for exchange differences arising from translation of long-term foreign currency monetary items" under previous GAAP, i.e., under AS 11. Thus, where a company with financial year 2018-19 as the first Ind AS reporting has applied the accounting treatment laid down by paragraph 46A in its financial statements for the financial year 2017-18, it can continue to apply the same accounting policy upon transition to Ind AS. In this regard, it is noted that a company applying paragraph 46A is required to apply the said paragraph (and not AS 16) to those exchange differences relating to long-term foreign currency monetary items also that otherwise qualify as being in the nature of adjustments to interest cost within the meaning of paragraph 4(e) of AS 16. Thus, a company that wishes to continue to avail of the exemption provided by paragraph D13AA of Ind AS 101 is not permitted to apply paragraph6 (e) of Ind AS 23, *Borrowing Costs*, to that part of exchange differences on such long-term foreign currency monetary items.

Issue 2: The issue relates to accounting treatment of Dividend Distribution Tax (DDT) in the consolidated financial statements of a parent where during the period covered by the financial statements, the parent receives a dividend from a subsidiary on which DDT has been paid by the subsidiary and the same is available for set off by the parent upon distribution of dividend by the parent to its shareholders. The distribution of dividend by the parent requires approval of the parent's shareholders at the annual general meeting which would take place after the end of the financial year.

In ITFG Clarification Bulletin 9, Issue 1, the following was stated:
"*….if based on evaluation of facts and circumstances, it is concluded that it is probable that the accumulated undistributed profits will be distributed in the foreseeable future, then DTL on accumulated undistributed profits of the subsidiary company should be recognised in the consolidated statement of profit and loss of the parent company. Where DDT paid by the subsidiary on distribution of its accumulated undistributed profits is allowed as a set off against the parent's own DDT liability, then the amount of such DDT can be recognised in the consolidated statement of changes in equity of parent by*

crediting an equivalent amount to deferred tax expense in the consolidated statement of profit and loss of P Ltd in the period in which the set-off is availed.

Further, the tax credit is not recognised until the conditions required to receive the tax credit are met. The tax credit on account of DDT paid by the subsidiary is recognised in the year in which they are claimed against parent's DDT liability. This is important because the payment of dividend by Parent P is decided by its shareholders and, therefore, not to recognise a DTL or to recognise any tax credit prior to such shareholder actions may not be appropriate. For example, shareholders of Parent P Ltd may decide not to distribute or even reduce the amount of dividends proposed by the Board of Directors of P Ltd."

In the context of the above clarification has been sought as to whether the above clarification would apply to those situations also where the given facts and circumstances are such that the parent has reasonable expectation that it will declare the dividend and will be able to take credit of the DDT paid by the subsidiary.

Response: While dealing with the issue in Bulletin 9, the intention of ITFG was not to preclude recognition of DDT credit in the consolidated financial statements in the period in which the parent receives dividend from a subsidiary in circumstances where, based on a proper evaluation of attendant facts and circumstances, the parent reasonably expects at the reporting date that it would be able to avail of the DDT credit upon declaration of dividend at its annual general meeting to be held after the end of the financial year. The response was directed at situations where, in the context of the attendant facts and circumstances, such reasonable expectation could not be said to exist at the reporting date. To avoid any doubts, the views of the ITFG are set out in detail below:

(i) At the time of distribution of dividend by a subsidiary to the parent (and consequent payment of DDT by the subsidiary), the parent should recognise the associated DDT credit as an asset to the extent that it is probable that a liability for DDT on distribution of dividend by the parent will arise against which the DDT credit can be utilised. To the extent that it is not probable that a liability for DDT on distribution of dividend by the parent will arise against which the DDT credit can be utilised, the amount of DDT paid by the subsidiary should be charged to profit or loss in the consolidated statement of profit and loss.

(ii) At the end of each reporting period, the carrying amount of DDT credit should be reviewed. The carrying amount of the DDT credit should be reduced to the extent that it is no longer probable that a liability for DDT on distribution of dividend by the parent will arise against which the DDT credit can be utilised. Conversely, any such reduction made in a previous reporting period should be reversed to the extent that it is now probable that a liability for DDT on distribution of dividend by the parent will arise against which the DDT credit can be utilised. The corresponding debit (for a reduction) or credit (for reversal of a previously recognised reduction) should be made to profit or loss in the consolidated statement of profit and loss.

(iii) At the end of each reporting period, the parent should reassess any unrecognised DDT credit. The parent should recognise a previously unrecognised DDT credit to the extent that it has become probable that a liability for DDT on distribution of dividend by the parent will arise against which the DDT credit can be utilised. The corresponding credit should be made to profit or loss in the consolidated statement of profit and loss.

(iv) To the extent the DDT credit is utilised to discharge the liability (or a part of the liability) of the parent for payment of DDT on distribution of dividend to its shareholders, the DDT credit should be extinguished by corresponding debit to the parent's liability for payment of DDT.

It would be noted from the above that the accounting treatment of DDT credit depends on whether or not it is probable that the parent will be able to utilise the same for set off against its liability to pay DDT. This assessment can be made only by considering the particular facts and circumstances of each case including the parent's policy regarding dividends, historical record of payment of dividends by the parent, availability of distributable profit and cash, etc.

Issue 3: S Ltd. has received an interest free loan from its holding company H Ltd which it is under obligation to repay at the end of five years. S Ltd. is required by Ind AS 109, *Financial Instruments*, to initially recognise the loan at its fair value determined in accordance with Ind AS 113, *Fair Value Measurement.* How should the difference between the loan amount and the fair value of the loan at initial recognition be accounted for at the time of initial recognition in the books of S Ltd?

Response: In the given case, since the subsidiary is under an obligation to repay the loan provided to it by the holding company, the loan represents a financial liability of the subsidiary and should be so recognised. On a consideration of the substance of the transaction and in the absence of any factors that lead to a different conclusion as to its nature, the excess of the loan amount over the fair value of the loan at initial recognition should appropriately be regarded as an equity infusion by the parent and should therefore be credited directly to equity.

Issue 4: XYZ Ltd. is a first-time adopter of Ind ASs with date of transition being April 1, 2017. A scheme of amalgamation was implemented in the year 2011-12 under the order of the High Court. As per the scheme, a particular item of the transferor company was capitalised by the transferee company. However, under Ind ASs, this item does not meet the definition of an asset and needs to be charged to profit or loss. XYZ Ltd. wishes to retrospectively restate the above business combination in accordance with Ind AS 103, *Business Combinations*. Other than the amalgamation referred to above, XYZ Ltd has not effected any business combination in the past.

Should the company consider the court scheme in carrying out retrospective restatement of the business combination?

Response: As has been clarified in the ITFG Clarification Bulletin 16 (Issue 5), accounting treatment of a transaction as required under an order of a court or tribunal (or other similar authority) overrides the accounting treatment that would otherwise be required to be followed in respect of the transaction and it is mandatory for the company concerned to follow the treatment as per the order of the court/tribunal.

Furthermore, the Companies (Indian Accounting Standards) Rules, 2015 provide as follows:

A. General Instruction. - (I) lndian Accounting Standards, which are specified, are intended to be in conformity with the provisions of applicable laws. However, if due to subsequent amendments in the law, a particular lndian Accounting Standard is found to be not in conformity with such law, the provisions of the said law shall prevail and the financial statements shall be prepared in conformity with such law.

Paragraph C1 of Ind AS 101 states that, *"A first-time adopter may elect not to apply Ind AS 103 retrospectively to past business combinations (business combinations that occurred before the date of transition to Ind ASs). However, if a first-time adopter restates any business combination to comply with Ind AS 103, it shall restate all later business combinations and shall also apply Ind AS 110 from that same date."*

For example, if a first-time adopter elects to restate a business combination that occurred on 30 June 2010, it shall restate all business combinations that occurred between 30 June 2010 and the date of transition to Ind ASs, and it shall also apply Ind AS 110 from 30 June 2010.

Based on the above, the position may be explained as follows:

- Where a business combination occurs on or after the date of transition by the entity to Ind ASs but the scheme approved by the relevant authority (Court or the National Company Law Tribunal) prescribes a treatment that differs from the treatment required as per Ind AS 103, the treatment prescribed under the scheme would override the requirements of Ind AS 103.
- Where a business combination occurred before the date of transition of the entity to Ind ASs but the scheme approved by the relevant authority (Court or the National Company Law Tribunal) prescribed a treatment that differs from the treatment required as per Ind AS 103, the issue whether the restatement of a business combination upon transition to Ind ASs is legally permissible requires a careful evaluation of the exact stipulations contained in the scheme. As the schemes approved by the relevant authorities have varying stipulations, each case requires a separate consideration of the issue of legal permissibility of restatement based on its specific facts. Where it is evaluated that under law, the scheme approved by the relevant authority does not preclude restatement upon transition to Ind ASs, the restatement is permissible subject to complying with the conditions laid down in this behalf in Ind AS 101.

In accordance with the above, if the company wishes to retrospectively apply Ind AS 103 to the business combination referred to in the query, the company needs to independently examine the legal permissibility of the proposed restatement in the specific facts of its case.

Issue 5: As at the end of its financial year 2017-18, Company A Limited had a wholly owned subsidiary, Company B Private Limited. Company A was covered in phase I of the Ind AS applicability and accordingly had prepared its first Ind AS financial statements for the year ended March 31, 2017 and thereafter for year ended March 31, 2018. Company B Private Limited being a subsidiary of Company A Limited had also prepared its financial statements for the aforesaid financial years as per Ind ASs even though it did not on its own meet the net worth criterion for applicability of Ind ASs.

During the financial year 2018-19, Company A Limited undertook a restructuring exercise, pursuant to which it transferred its shareholding in Company B Private Limited to its promoters who are individuals and therefore not required to comply with Ind ASs. Subsequent to the transfer, the promoters converted Company B Private Limited from a company to a Limited Liability Partnership (LLP), Entity B LLP following the due process of law.

Whether the LLP needs to continue to prepare its financial statements under Ind AS from the financial year 2018-19 and onwards?

Response: The Companies (Indian Accounting Standards) Rules, 2015 ('the Rules') have been issued by the Central Government pursuant to powers conferred on it by section 133 read with section 469 of the Companies Act, 2013 ('the Act'). Subject to certain exceptions, the Rules require a company falling in any of classes of companies specified in this behalf in the Rules to follow Indian Accounting Standards (that are part of the Rules) in preparation of its financial statements under section 129 of the Act.

A limited liability partnership is governed by the provisions of the Limited Liability Partnership Act, 2008 and the Rules made thereunder.

Once a company gets converted from a company into a limited liability partnership, the Companies Act 2013 and the Rules framed thereunder cease to apply to it. As a limited liability partnership, it is instead governed by the provisions of the Limited Liability Partnership Act 2008 and the Rules framed thereunder. Consequently, in the given case, upon conversion of Company B Private Limited into an LLP, Ind ASs cease to apply to it.

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