Ind AS Transition Facilitation Group (ITFG) Clarification Bulletin 11

'Ind AS Transition Facilitation Group' (ITFG) of Ind AS 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 clarifications[1] on July 31, 2017:

Issue 1: Whether ESOP reserve is required to be included while computing net worth of a company to assess applicability of Ind AS on the company?

Response: As per Rule 2(1)(f) of Companies (Indian Accounting Standards) Rules, 2015, "net worth" shall have the meaning assigned to it as in clause (57) of section 2 of the Act.

Further, as per Section 2(57) of the Companies Act, 2013, *"net worth means the aggregate value of the paid-up share capital and all reserves created out of the profits and securities premium account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation."*

It may be noted that the Guidance Note on Accounting for Employee Share-based Payments, *inter alia,* provides that *an enterprise should recognise as an expense (except where service received qualifies to be included as a part of the cost of an asset) the services received in an equity-settled employee share-based payment plan when it receives the services, with a corresponding credit to an appropriate equity account, say, 'Stock Options Outstanding Account'. This account is transitional in nature as it gets ultimately transferred to another equity account such as share capital, securities premium account and/or general reserve as recommended in the subsequent paragraphs of this Guidance Note*.

In accordance with the above, ESOP reserve is required to be included while calculating the net worth of a company.

However, this clarification is only for the purpose of Ind AS applicability and should not be applied by analogy for determining net worth under other provisions of the Companies Act, 2013.

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[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 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: Under the previous GAAP, ASI 3, *Accounting for Taxes on Income in the situations of Tax Holiday under Sections 80-IA and 80-IB of the Income-tax Act, 1961* and ASI 6 *Accounting for Taxes on Income in the context of Section 115JB of the Income-tax Act, 1961* provides guidance on how AS 22, *Accounting for Taxes on Income* is to be applied in the situations of tax holiday under section 80-IA and 80-IB of the Act.

Whether the same treatment can be applied under Ind AS?

Response: The consensus portion of ASI 3*, Accounting for Taxes on Income in the situations of Tax Holiday under Sections 80-IA and 80-IB of the Income-tax Act, 1961*, was included as 'Explanation' to the paragraph 13 of Accounting Standard (AS) 22, '*Accounting for Taxes on Income*', notified under the Companies (Accounting Standards) Rules, 2006. Accordingly, it became the part of notified Accounting Standards. The ASIs are also not effective in context of Indian Accounting Standards notified under Companies (Indian Accounting Standards) Rules, 2015.

However, under Ind AS, the principles enunciated in Ind AS 12, *Income Taxes* is required to be applied. The treatment as per AS 22 may be applied where such treatment is consistent with the principles of Ind AS 12. Paragraphs 26-29 of Ind AS 12 can be referred for the recognition of deferred tax as they provide sufficient guidance in this regard. Ind AS 12 provides that a deferred tax asset can result from unused tax losses and tax credits as well as from temporary differences. Deferred tax assets can only be recognised if it is probable that there will be taxable profit available against which the deductible temporary differences can be utilised/future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised. Further, paragraph 47 of Ind AS 12 states that *deferred tax assets and liabilities shall be measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.*

Accordingly, the deferred tax in respect of temporary differences which reverse during the tax holiday period is not recognised to the extent the entity's gross total income is subject to the deduction during the tax holiday period as per the requirements of section 80IA/80IB of the Income Tax Act, 1961.

Issue 3: Paragraph 9 of Ind AS 33, *Earnings per Share* states that, *"An entity shall calculate basic earnings per share amounts for profit or loss attributable to ordinary equity holders of the parent entity and, if presented, profit or loss from continuing operations attributable to those equity holders."*

Does this mean that a subsidiary company, not wholly owned, should present EPS only for the portion of the profit which is attributable to the parent entity?

Response: Paragraph 4 of Ind AS 33 states as follows:

"4 When an entity presents both consolidated financial statements and separate financial statements prepared in accordance with Ind AS 110, Consolidated Financial Statements, and Ind AS 27, Separate Financial Statements, respectively, the disclosures required by this Standard shall be presented both in the consolidated financial statements and separate financial statements. In consolidated financial statements such disclosures shall be based on consolidated information and in separate financial statements such disclosures shall be based on information given in separate financial statements. An entity shall not present in consolidated financial statements, earnings per share based on the information given in separate financial statements and shall not present in separate financial statements, earnings per share based on the information given in consolidated financial statements."

In accordance with the above an entity is required to disclose EPS in both its Standalone financial statements (SFS) and in Consolidated Financial statements (CFS) (if presented by the entity).

Paragraph 9 states that an entity shall calculate basic earnings per share amounts for profit or loss attributable to ordinary equity holders of the parent entity and, if presented, profit or loss from continuing operations attributable to those equity holders.

Further, paragraph A1 of Appendix A of Ind AS 33 also states that, *"For the purpose of calculating earnings per share based on the consolidated financial statements, profit or loss attributable to the parent entity refers to profit or loss of the consolidated entity after adjusting for non- controlling interests."*

It is pertinent to note that the requirements of paragraph 9 of Ind AS 33 have been provided in the context of calculating EPS in the consolidated financial statements of an entity.

However, analogy may be drawn from paragraph 9 of Ind AS 33 that in case of separate financial statements, the parent entity mentioned in paragraph 9 will imply the legal entity of which separate financial statements are being prepared and accordingly, when an entity presents EPS in its separate financial statements, then the same shall be calculated based on the profit or loss attributable to its equity shareholders.

Issue 4: MNC Ltd is a first-time adopter of Ind AS. At the date of transition to Ind AS, it has opted to measure its investment in subsidiary at deemed cost as per paragraph D15 of Ind AS 101, *First-time Adoption of Indian Accounting Standards*. Whether in its first Ind AS financial statements prepared as at the end of the reporting period, MNC Ltd. is required to measure its investment in subsidiary at cost only or it has the option to measure the investment as per Ind AS 109 in accordance with paragraph 10 of Ind AS 27?

Response: Paragraph D14 and D 15 of Ind AS 101 states as follows:

"D14 When an entity prepares separate financial statements, Ind AS 27 requires it to account for its investments in subsidiaries, joint ventures and associates either:
(a) at cost; or
(b) in accordance with Ind AS 109.

D15 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."

In accordance with the above, it may be noted that deemed cost exemption under paragraph D15 is available to an entity when it chooses to measure the investment at cost in accordance with Ind AS 27. Accordingly, an entity may in its opening Ind AS balance sheet measure its investment in subsidiaries as at the date of transition at its deemed cost measured in accordance with paragraph D15 provided it adopts to measure its investment in subsidiaries at cost in accordance with Ind AS 27.

Further, paragraph 7 of Ind AS 101 states that, *"An entity shall use the* ***same accounting policies in its opening Ind AS Balance Sheet and throughout all periods presented in its first Ind AS financial statement****s. Those accounting policies shall comply with each Ind AS effective at the end of its first Ind AS reporting period, except as specified in paragraphs 13–19 and Appendices B–D."*

Accordingly, if an entity has opted to measure its investments in subsidiaries at cost for its opening Ind AS balance sheet, then the same accounting policy will be applied for its closing Ind AS balance sheet as well. Accordingly, if a company chooses to measure its investment in subsidiary at the date of transition at deemed cost measured as per paragraph D15, then it shall carry such investment at that amount (i.e. deemed cost as per paragraph D15) in its first Ind AS financial statements prepared as at the end of the reporting period.

The requirements in D14 and D15 applies to investments held in subsidiaries as at the date of transition. However, for all investment in subsidiaries, joint ventures and associates made subsequent to the date of transition, the requirements of paragraph 10 of Ind AS 27 as stated below shall apply:

"*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."

The entity shall apply the same accounting for each category of investments. Investments accounted for at cost shall be accounted for in accordance with Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations, when they are classified as held for sale (or included in a disposal group that is classified as held for sale). The measurement of investments accounted for in accordance with Ind AS 109 is not changed in such circumstances."

In accordance with the above, if the entity has opted to measure the investments at deemed cost on the date of transition to Ind AS in its opening Ind AS balance sheet, then all subsequent investments made in that category should be measured at cost in accordance with Ind AS 27 in its financial statements prepared as at the end of the reporting period. However, for the investment made in different category (e.g. associate or joint venture), the entity has an option to account for those investments at cost or in accordance with Ind AS 109.

Issue 5: MNC Ltd. has received grant in the nature of exemption of custom duty on capital goods with certain conditions related to export of goods under Export Promotion Capital Goods (EPCG) scheme of Government of India. Whether the same is a government grant under Ind AS 20, Government Grants and Disclosure of Government Assistance? If yes, then whether it is a Grant related to asset or Grant related to income and how the same is to be accounted for?

Response: Paragraph 3 of Ind AS 20, *Government Grants and Disclosure of Government Assistance*, states as follows:

"3 Government grants are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the entity."

In accordance with the above, in the given case exemption of custom duty under EPCG scheme is a government grant and should be accounted for as per the provisions of Ind AS 20.

Ind AS 20 defines grant related to assets and grants related to income as follows:

*"**Grants related to asse**t are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire long-term assets. Subsidiary conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held.*

Grants related to income *are government grants other than those related to assets."*

It is pertinent to note that the classification of the grant as related to asset or income will require exercise of judgement and careful examination of the facts, objective and conditions attached to the scheme of the government. Care is also required to ascertain the purpose of the grant and the costs for which the grant is intended to compensate.

Based on the evaluation of facts, if it is ascertained that the grant is an asset related grant then the same shall be presented as per paragraph 24 & 26 of Ind AS 20 which has been stated below:

Presentation of grants related to assets

24 Government grants related to assets, including non-monetary grants at fair value, shall be presented in the balance sheet by setting up the grant as deferred income.

26 The grant set up as deferred income is recognised in profit or loss on a systematic basis over the useful life of the asset."

If it is determined that the grant is related to income then the same shall be presented as follows:

Presentation of grants related to income

29 Grants related to income are presented as part of profit or loss, either separately or under a general heading such as 'Other income'; alternatively, they are deducted in reporting the related expense.

It may be further noted that as per paragraph 12 of Ind AS 20, government grants shall be accounted as follows:

"12 Government grants shall be recognised in profit or loss on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate

In the given case, if based on the terms and conditions of the scheme, the grant received is to compensate the import cost of assets subject to an export obligation as prescribed in the EPCG Scheme; recognition of grant in the statement of profit and loss should be linked to fulfilment of associated export obligations.

However, if the grant received is to compensate the import cost of the asset and based on the examination of the terms and conditions of the grant, if it can be reasonably concluded that conditions relating to export of goods are subsidiary conditions, then it is appropriate to recognise such grant in profit or loss over the life of the underlying asset.

Issue 6: PQR Ltd. is the subsidiary company of MNC Ltd. In the standalone financial statements prepared in accordance with Ind AS, PQR Ltd. has adopted Straight-line method (SLM) of depreciation and MNC Ltd. has adopted Written-down value method (WDV) for depreciating its property, plant and equipment. As per Ind AS 110, *Consolidated Financial Statements*, a parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances.

How will these property, plant and equipment be depreciated in the consolidated financial statements of MNC Ltd. prepared as per Ind AS?

Response: Paragraph 19 and paragraph B87 of Ind AS 110, *Consolidated Financial Statements* states as follows:

> *"19 A parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances.*
>
> *B87 If a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to that group member's financial statements in preparing the consolidated financial statements to ensure conformity with the group's accounting policies."*

It may be noted that the above mentioned paragraphs requires an entity to apply uniform accounting policies for like transactions and events in similar circumstances. It does not apply to accounting estimates made while preparing financial statements.

Further, paragraphs 60 & 61 of Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors,* state as follows:

> *"60 The depreciation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.*
>
> *61 The depreciation method applied to an asset shall be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method shall be changed to reflect the changed pattern.* ***Such a change shall be accounted for as a change in an accounting estimate in accordance with Ind AS 8****."(Emphasis added)*

In accordance with the above, it may be noted that the selection of the method of depreciation is an accounting estimate and not an accounting policy.

Accordingly, the entity should select the method that most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. That method should be applied consistently from period to period unless there is a change in the expected

pattern of consumption of those future economic benefits in separate financial statements as well as consolidated financial statements.

Therefore, there can be different methods of estimating depreciation for property, plant and equipment, if their expected pattern of consumption is different. The method once selected in the standalone financial statements of the subsidiary should not be changed while preparing the consolidated financial statements.

Accordingly, in the given case, the property, plant and equipment of PQR Ltd. (subsidiary company) may be depreciated using straight line method and property, plant and equipment of parent company (MNC Ltd.) may be depreciated using written down value method, if such method closely reflects the expected pattern of consumption of future economic benefits embodied in the respective assets.

Issue 7: A Ltd. is a first-time adopter of Ind AS. It had incorporated a partnership firm with B Ltd. namely, M/s A&B Associates. Whether Ind AS will be applicable to M/s A & B Associates by virtue of the fact that Ind AS is applicable to A Ltd?

Also clarify, whether Ind AS will be applicable to non-corporate entities?

Response: The applicability of Ind AS has been specified for classes of companies specified in Rule 4 of Companies (Indian Accounting Standards) Rules, 2015. Indian Accounting Standards notified under the Companies (Indian Accounting Standards) Rules, 2015, are applicable for the corporates only. Non- corporates are required to follow the accounting standards issued by the Institute of Chartered Accountants of India.. They cannot be applied by non-corporate entities even voluntarily.

However, in case, a relevant regulator specifically provides for implementation of Ind AS, the non-corporate entities shall apply Ind AS, for example, SEBI has mandated implementation of Ind AS for Infrastructure Investment Trusts (InvITs) and Real Estate Investment Trusts (REITs). Similarly, if Central Government notifies certain body corporate under clause (1)(4)(f) of Companies Act, 2013, such entities will be required to apply Ind AS. For other non-company entities, Accounting Standards issued by the ICAI shall be applicable and there will be no option to follow Ind AS to such entities.

Accordingly, in the given case, Ind AS is not applicable to partnership firms. However, for the purpose of consolidation, the partnership firm will be required to provide financial statements data prepared as per Ind AS to A Ltd provided the partnership qualifies as a subsidiary/joint venture/associate of A Ltd.

Issue 8: ABC Ltd is setting up a new refinery outside the city limits. In order to facilitate the construction of the refinery and its operations, ABC Ltd. is required to incur expenditure on the construction/development of railway siding, road and bridge. Though ABC Ltd. incurs (or contributes to) the expenditure on the

construction/development, it will not have ownership rights on these items and they are also available for use to other entities and public at large. Whether ABC Ltd. can capitalize expenditure incurred on these items as property, plant and equipment (PPE)? If yes, how should these items be depreciated and presented in the financial statements of ABC Ltd.?

Response: Paragraph 7 of Ind AS 16 states that *"the cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:*

a) it is probable that future economic benefits associated with the item will flow to the entity; and

b) the cost of the item can be measured reliably."

Further paragraph 9 of Ind AS 16 provides that, *"This Standard does not prescribe the unit of measure for recognition, i.e., what constitutes an item of property, plant and equipment. Thus, judgement is required in applying the recognition criteria to an entity's specific circumstances. It may be appropriate to aggregate individually insignificant items, such as moulds, tools and dies, and to apply the criteria to the aggregate value*."

Paragraph 16 of Ind AS 16, *inter alia*, states that *the cost of an item of property, plant and equipment comprise any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management*.

In the given case, railway siding, road and bridge are required to facilitate the construction of the refinery and for its operations. Expenditure on these items is required to be incurred in order to get future economic benefits from the project as a whole which can be considered as the unit of measure for the purpose of capitalisation of the said expenditure even though the company cannot restrict the access of others for using the assets individually. It is apparent that the aforesaid expenditure is directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

In view of this, even though ABC Ltd. may not be able to recognise expenditure incurred on these assets as an individual item of property, plant and equipment in many cases (where it cannot restrict others from using the asset), expenditure incurred may be capitalised as a part of overall cost of the project. From this, it can be concluded that, in the extant case the expenditure incurred on these assets, i.e., railway siding, road and bridge, should be considered as the cost of constructing the refinery and accordingly, expenditure incurred on these items should be allocated and capitalised as part of the items of property, plant and equipment of the refinery.

Depreciation

As per paragraph 43 of Ind AS 16, each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately.

Further paragraph 45 of Ind AS 16 provides that, a significant part of an item of property, plant and equipment may have a useful life and a depreciation method that are the same as the useful life and the depreciation method of another significant part of that same item. Such parts may be grouped in determining the depreciation charge.

In view of the above, if these assets have a useful life which is different from the useful life of the item of property, plant and equipment to which they relate, it should be depreciated separately. However, if these assets have a useful life and the depreciation method that are the same as the useful life and the depreciation method of the item of property, plant and equipment to which they relate, these assets may be grouped in determining the depreciation charge. Nevertheless, if it has been included in the cost of property, plant and equipment as a directly attributable cost, it will be depreciated over the useful lives of the said property, plant and equipment. The useful lives of these assets should not exceed that of the asset to which it relates.

Presentation

These assets should be presented within the class of asset to which they relate.

Issue 9: Whether sitting fees paid to independent director and Non-executive director is required to be disclosed in the financial statements prepared as per Ind AS?

Response: As per paragraph 9 of Ind AS 24, *Related Party Disclosures, "Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity."*

In accordance with the above definition, key management personnel (KMP) includes any director of the entity who are having authority and responsibility for planning, directing and controlling the activities of the entity. Accordingly, independent and non-executive directors are also covered under the definition of KMP in accordance with Ind AS.

Paragraph 17 of Ind AS 24 requires the following disclosures about employee benefits for key management personnel:

"*An entity shall disclose key management personnel compensation in total and for each of the following categories:*

(a) short-term employee benefits;

(b) post-employment benefits;

(c) other long-term benefits;

(d) termination benefits; and

(e) share-based payment."

Further, paragraph 7 and 9 of Ind AS 19, *Employee Benefits*, states that-

*"7 An employee may provide services to an entity on a full-time, part-time, permanent, casual or temporary basis. For the purpose of this Standard, **employees include directors and other management personnel."***

*"9 Short-term employee benefits include items such as the following, **if expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related services**:*

(a) wages, salaries and social security contributions;

(b) paid annual leave and paid sick leave;

(c) profit-sharing and bonuses; and

(d) non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees."

In accordance with the above provisions, non- executive directors meeting this criteria are covered under the definition of key management personnel. The sitting fees paid to directors will fall under the definition of "Short-term employee benefits" as per Ind AS 19 and is required to be disclosed in accordance with the paragraph 17 of Ind AS 24.

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