

Ind AS Technical Facilitation Group Clarification Bulletin 22

Ind AS Technical 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, and other amendments finalised and notified till March 2019, raised by preparers, users and other stakeholders. Ind AS Technical Facilitation Group (ITFG) considered some issues received from members and decided to issue following clarifications¹ on October 14, 2019:

Issue 1:

Ind AS 116, Leases, is applicable for annual reporting periods beginning on or after April 1, 2019. Entity X has applied Ind AS 116 using modified retrospective approach, under which the cumulative effect of initial application is recognised in retained earnings as on April 1, 2019.

Entity X is in the business of power generation and transmission and has power transmission licence for a period of 30 years and intends to stay in the business for at least the aforesaid period of 30 years. Entity X has entered into following lease arrangements:

(a) Lease 1

During the year 2015, Entity X (lessee) entered into a lease arrangement with Entity Y (lessor), a government-owned railway operator for an overhead line facility across the railway track for a period of 10 years. Entity X paid ‘way leave’ charge to Entity Y for the right of way in advance for the entire period of 10 years. As per the contractual terms, Entity X has no tenancy or right or interest in the land.

As per the past practice followed by Entity Y in respect of its other similar leases, it is likely that the contract will be renewed for another ten year at the expiry of its current term.

The following are some of the principal terms of agreement.

- (i) Either party shall be at liberty to put an end to the arrangement by giving one-month previous notice in writing to that effect. In the event of such a notice being given by Entity Y, Entity X shall have no claim for any compensation whatsoever.**

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 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 this Bulletin is October 14, 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.

- (ii) Entity Y reserves full rights to enter upon pass through or use the land at any time without any notice to Entity X.**
- (iii) In case Entity Y gives the notice, Entity X shall at its own cost remove under the supervision of Entity Y the transmission line and shall restore the railway land to its original condition to the satisfaction of the Entity Y in all respects.**
- (iv) Neither Entity X nor its employees or agents shall at any time enter upon the railway land or within railway limits for any purpose whatsoever in connection with the said transmission line facility without the previous consent in writing of Entity Y.**
- (v) Entity X shall not transfer or sublet the rights granted by the way leave facility and the benefit of the facility shall be restricted to it only.**
- (vi) Entity X shall execute the work as per plan approved by Entity Y and as per specification of materials laid down by Entity Y from time to time and strictly under supervision of Entity Y's representatives.**
- (vii) Entity X shall use the facility granted only for the purpose for which it has been granted (i.e. for transmission line) and without conferring upon it any right of possession or occupation of land and without in any way affecting Entity Y's title, possession, control and use of the land.**

LEASE 2:

A part of the transmission line also passes through private land held by Entity Z. During the year 2015, Entity X (lessee) entered into a lease agreement with Entity Z (lessor) for a period of 12 months for overhead facility. Since the year 2015, the contract has been renewed every year for a further period of one year at a time.

The following are some of the principal terms of agreement.

- (i) The lease can be renewed or cancelled with the mutual consent of both the parties.**
- (ii) Either party shall be at liberty to put an end to the arrangement by giving one-month previous notice in writing to that effect and in the event of such a notice neither of the party shall have any claim for any compensation whatsoever.**
- (iii) Entity X shall not transfer or sublet the rights granted by Entity Z and the benefit of the facility shall be restricted to it only.**

As per the past practice, it is likely that the contract will be renewed for another one year at the expiry of its current term. The lease agreement does not provide any purchase option in respect of the leased asset to the lessee.

(c) LEASE 3:

In year 2016, Entity X enters into a lease agreement with a warehouse for an initial non-cancellable period of one year. The lease can be renewed for a further period of one year with the mutual consent of both the parties. There is no penalty if the lessee and the lessor do not agree. Since 2016, the contract has been renewed every year for a further period of one year at a time.

As per the past practice, it is likely that the contract will be renewed for another one year at the expiry of its current term. The lease agreement does not provide any purchase option in respect of the leased asset to the lessee.

Entity X is reasonably certain to continue Lease 1 and Lease 2 till the validity of transmission licence, i.e. 30 years since shifting of transmission lines will affect its business adversely. Further, in the past, Entity Y has given notice to lessees to shift transmission lines from railway land only in a few rare and unusual cases.

Whether the recognition exemption for short term leases as per paragraph 5 of Ind AS 116, *Leases*, is available to Entity X for the above three leases?

Response:

(The analysis deals with the issue of determination of lease term under Ind AS 116 and does not deal with any other accounting aspect that may be relevant, e.g., application of transitional provisions)

Paragraph 5 of Ind AS 116, *Leases*, states the following, inter alia:

“A lessee may elect not to apply the requirements in paragraphs 22- 49 to:

- (a) short-term leases; and*
- (b)”*

Ind AS 116 (or ‘the Standard’) defines the terms ‘lease term’ and ‘short-term lease’ as follows:

Lease term

“The non-cancellable period for which a lessee has the right to use an underlying asset, together with both:

- (a) periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and*
- (b) periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.”*

Short-term lease

“A lease that, at the commencement date, has a lease term of 12 months or less. A lease that contains a purchase option is not a short-term lease.”

Paragraph B34 of Ind AS 116 states the following, inter alia:

“In determining the lease term and assessing the length of the non-cancellable period of a lease, an entity shall apply the definition of a contract and determine the period for which the contract is enforceable.”

The term ‘contract’ is defined in the standard as follows:

“An agreement between two or more parties that creates enforceable rights and obligations.”

As per a combined reading of the above, in determining the lease term (and therefore, in determining whether a lease is a short-term lease), only the enforceable rights of the lessee to renew or extend the lease beyond the non-cancellable period are taken into consideration. For example:

- Where a lease agreement grants the lessee a right (an option) to renew or extend the lease beyond the non-cancellable period *without* the consent of the lessor, the lessee has the *right* to use the asset beyond the non-cancellable period. Accordingly, the period covered by the lessee’s option to renew or extend the lease is included in the lease term if the lessee is reasonably certain to exercise that option.
- In contrast, where a lease agreement can be renewed or extended by the lessee beyond the non-cancellable period *only with* the consent of the lessor, the lessee does not have the *right* to use the asset beyond the non-cancellable period. By definition, there is no contract beyond the non-cancellable period if there are no enforceable rights and obligations existing between the lessee and lessor beyond that term.

In view of the above, where a lease agreement (including any addendum thereto or a side agreement) is entered into for a period of 12 months or less and does not grant a renewal or extension option to the lessee, it qualifies as a short-term lease within the meaning of the standard (provided it also does not grant a purchase option to the lessee). This is so even if there is a past practice of the lease being renewed upon expiry for a further one year at a time with the mutual consent of the lessee and the lessor.

Conversely, where a lease agreement grants a renewal or extension option to the lessee, the lessee is required to determine whether it is reasonably certain to extend the lease.

Paragraph 19 of Ind AS 116 states the following inter alia-

“In assessing whether a lessee is reasonably certain to exercise an option to extend a lease, or not to exercise an option to terminate a lease, an entity shall consider all relevant facts and circumstances that create an economic incentive for the lessee to

exercise the option to extend the lease, or not to exercise the option to terminate the lease, as described in paragraphs B37– B40.”

Further, paragraph B37 of Ind AS 116 states the following inter alia

“B37 At the commencement date, an entity assesses whether the lessee is reasonably certain to exercise an option to extend the lease or to purchase the underlying asset, or not to exercise an option to terminate the lease. The entity considers all relevant facts and circumstances 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. Examples of factors to consider include, but are not limited to:

- (a)*
- (b) significant leasehold improvements undertaken (or expected to be undertaken) over the term of the contract that are expected to have significant economic benefit for the lessee when the option to extend or terminate the lease, or to purchase the underlying asset, becomes exercisable;*
- (c) costs relating to the termination of the lease, such as negotiation costs, relocation costs, costs of identifying another underlying asset suitable for the lessee’s needs, costs of integrating a new asset into the lessee’s operations, or termination penalties and similar costs, including costs associated with returning the underlying asset in a contractually specified condition or to a contractually specified location;*
- (e) the importance of that underlying asset to the lessee’s operations, considering, for example, whether the underlying asset is a specialised asset, the location of the underlying asset and the availability of suitable alternatives; and.....”*

On the basis of the above requirements of Ind AS 116, the lease term in respect of each of the leases described in the query would be as follows.

Lease 1

As per the facts of the case, the lease covers a period of 10 years. However, Entity X (or Entity Y) can terminate the lease by giving one month’s prior notice. Determining the lease term, therefore, requires an assessment as to whether, at lease commencement, there is an economic incentive for Entity X to not exercise the option to terminate the lease prematurely. This assessment needs to be made by Entity X by considering all relevant facts and circumstances including any expected changes in facts and circumstances during the 10-year period. However, the following factors *prima facie* suggest that at the commencement date, Entity X is not likely to have an economic incentive to exercise the termination option.

- Entity X expects to operate the transmission line for 30 years. It, therefore, needs the right of way for a period of 30 years which is well in excess of the 10-year period covered by the lease.
- In case Entity X wishes to relocate the transmission line so that it crosses over the railway track at a different location, in all likelihood, it will still have to obtain the right of way from Entity Y (since in India railway tracks and adjoining land are owned mostly by a single entity, viz. Indian Railways) and it seems unlikely that the lease rentals for the alternative location would be significantly lesser to justify the relocation.
- It seems possible that Entity X may not be able to have a complete transmission line without crossing over the railway track. Even where this is technically possible, the alternative route may involve a considerable increase in the length of the transmission line and may therefore involve considerable additional cost. *Prima facie*, any savings to Entity X due to lower lease rentals (which are likely to be the primary drivers behind any relocation decision) are likely to be significantly less than the cost involved in relocation.
- In case the premature termination by Entity X would result in Entity Y forfeiting a significant part of the advance lease rental payment, this would be an additional factor providing economic incentive to Entity X to not terminate the lease prematurely.

It is noted that Entity Y is government-owned. While its agreement with Entity X gives it a right to terminate the lease at any time, it seems *prima facie* that this right is meant to be exercised only in exceptional circumstances. At lease commencement, there seems no economic incentive for Entity Y to terminate the lease prematurely. In case another entity approaches Entity Y for the right of way, it seems that it can provide the right of way at some distance from location of transmission line of Entity X; it does not need to terminate its existing arrangement with Entity X to provide right of way to another party.

The above factors *prima facie* suggest that at lease commencement, it is reasonably certain that the termination option will not be exercised. However, as mentioned earlier, the final determination of the issue will have to be made by Entity X on the basis of its detailed and in-depth knowledge of the facts and circumstances of the case. In case Entity X 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'.

Lease 2 & Lease 3²

The lease agreement is for a period of 12 months. The agreement does not grant a renewal or extension or purchase option to Entity X (i.e., the renewal of lease requires mutual consent of Entity X and Entity Y and is not at the option of Entity X only). Accordingly, the lease

² It may also be noted a similar issue (where the renewal of lease requires mutual consent of lessor and lessee and is not at the option of lessee only) was dealt in ITFG Clarification Bulletin 21 (Issue 1).

qualifies as a ‘short-term lease’, notwithstanding the fact that in the past, upon expiry of each 12-month period, the lease has been renewed for a further period of 12 months. Entity X can, therefore, avail the exemption of not applying the lessee accounting model of the standard to the lease and instead account for the lease as per paragraph 6 of the Standard.

Issue 2:

Entity Y (lessor) entered into a lease agreement to provide on lease an office building to Entity X (lessee) for a 5-year term commencing April 1, 2017. As per the lease agreement, the lease rental for the first year was ₹ 5 lakh. The lease rental for each subsequent year was to increase by 10% over the lease rental for the immediately preceding year, e.g., the lease rental for the year 2018-19 was to be ₹ 5,50,000, for the year 2019-20 to be ₹ 6,05,000, and so on. The scheduled 10% annual increase in lease rentals was in line with expected general inflation to compensate for Y Limited’s expected inflationary cost increases.

The lease was classified by Y Limited as an operating lease. Applying paragraph 50(b) of Ind AS 17, *Leases*, Entity Y recognised lease rental income of ₹ 5,00,000 for the year 2017-18 and ₹ 5,50,000 for the year 2018-19. In other words, Y Limited did not recognise the lease rental income on a straight-line basis.

Ind AS 116, *Leases*, has become applicable for accounting years commencing April 1, 2019.

Under Ind AS 116, is Y Limited required to account for the lease rental income in respect of the aforesaid lease in the same way as it did under Ind AS 17?

Response:

Ind AS 17 stated the following in respect of accounting for operating leases by a lessor:

“50 Lease income from operating leases (excluding amounts for services such as insurance and maintenance) shall be recognised in income on a straight-line basis over the lease term, unless either:

- (a) another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished, even if the payments to the lessors are not on that basis; or*
- (b) the payments to the lessor are structured to increase in line with expected general inflation to compensate for the lessor’s expected inflationary cost increases. If payments to the lessor vary according to factors other than inflation, then this condition is not met.”*

Sub-paragraph (b) of paragraph 50 of Ind AS 17 represented a conscious departure (a carve-out) from the corresponding Standard under International Financial Reporting Standards, viz., IAS 17, *Leases*, which required operating lease rentals to be recognised by a lessor on a straight-line basis unless another systematic basis was more representative of the time pattern

in which use benefit derived from the leased asset was diminished, even if the payments to the lessors were not on that basis. Thus, unlike IAS 17, Ind AS 17 did not require or permit scheduled lease rental increases to be recognised on a straight-line basis over the lease term if lease rentals were structured to increase in line with expected general inflation to compensate for the lessor's expected inflationary cost increases. Instead, Ind AS 17 required such increases to be recognised in the respective period of increase only.

Ind AS 116, which has replaced Ind AS 17 in respect of accounting years commencing on or after April 1, 2019, states the following in respect of accounting for operating leases by a lessor.

“81 A lessor shall recognise 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 benefit from the use of the underlying asset is diminished.”

It would be noted that Ind AS 116 does not carry forward the carve out that Ind AS 17 made from IAS 17 and requires operating lease rentals to be recognised on a straight-line basis (or on another systematic basis if such other basis is more representative of the pattern in which benefit from the use of the underlying asset is diminished).

In view of the above, in the given case under Ind AS 116, Y Limited is required to recognise operating lease rentals from the office building given on lease on a straight-line basis over the lease term, notwithstanding that the lease rentals are structured to increase in line with expected general inflation to compensate for its expected inflationary cost increases.

The resultant change in manner of recognition of operating lease rentals by Y Limited represents 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.

Issue 3: ABC Limited, a cement manufacturer has entered into a lease agreement with PQR Limited for rights for the extraction of lime stone which is the principal raw material for manufacture of cement.

Whether the rights for extraction of lime stone are covered under the scope of Ind AS 106, *Exploration for and Evaluation of Mineral Resources*? How should these rights be accounted for? In case rights are to be accounted for as an intangible asset, should the amortisation be based on the 'lease term' in terms of number of years or based on quantity of mineral reserves?

Response:

The principal issue in the present case is to identify the Ind AS which governs accounting for mining lease rights in question. In this context, the following extracts from Ind AS 38,

Intangible Assets, Ind AS 16, Property, Plant and Equipment, Ind AS 116, Leases, and Ind AS 106, Exploration for and Evaluation of Mineral Resources, are noteworthy.

Extracts from Ind AS 38

“2 This Standard shall be applied in accounting for intangible assets, except:

.....

- (c) the recognition and measurement of exploration and evaluation assets (see Ind AS 106, Exploration for and Evaluation of Mineral Resources); and*
- (d) expenditure on the development and extraction of minerals, oil, natural gas and similar non-regenerative resources.”*

Extracts from Ind AS 16

3 This Standard does not apply to:

.....

- (c) the recognition and measurement of exploration and evaluation assets (see Ind AS 106, Exploration for and Evaluation of Mineral Resources).*
- (d) mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources.*

Extracts from Ind AS 116

“2 An entity shall apply this Standard to all leases, including leases of right-of-use assets in a sublease, except for:

- (a) leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources;*

.....”

Extracts from Ind AS 106

Exploration for and evaluation of mineral resources – “The search for mineral resources, including minerals, oil, natural gas and similar non-regenerative resources after the entity has obtained legal rights to explore in a specific area, as well as the determination of the technical feasibility and commercial viability of extracting the mineral resource.”

“3 An entity shall apply this Ind AS to exploration and evaluation expenditures that it incurs.”

“6 An entity shall not apply this Ind AS to expenditures incurred:

- (a) *before the exploration for and evaluation of mineral resources, such as expenditures incurred before the entity has obtained the legal rights to explore a specific area.*
- (b) *after the technical feasibility and commercial viability of extracting a mineral resource are demonstrable.”*

“17 An exploration and evaluation asset shall no longer be classified as such when the technical feasibility and commercial viability of extracting a mineral resource are demonstrable. Exploration and evaluation assets shall be assessed for impairment, and any impairment loss recognised, before reclassification.”

As per a combined reading of the above, the mining lease rights under discussion qualify as an intangible asset to be accounted for as per Ind AS 38 as explained in detail below:

- The rights acquired are for the extraction of lime stone which means that technical feasibility and commercial viability of extracting the limestone has already been established. Therefore, the present case does not fall under the scope of Ind AS 106.
- Ind AS 16 does not apply to mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources. Leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources are also excluded from the scope of Ind AS 116.
- The mining lease rights under discussion qualify as an intangible asset under Ind AS 38. The scope exclusions contained in paragraphs 2(c) and 2(d) do not apply to these rights because
 - these rights relate not to a mine in exploration and evaluation stage but to a mine for which the technical feasibility and commercial viability of extracting the limestone has already been determined and hence the present case does not fall under the scope exclusion in paragraph 2(c) of Ind AS 38.
 - the payment made (or to be made) by the entity for obtaining the mining lease rights is neither expenditure on ‘development’ nor on ‘extraction’ of minerals or other non-regenerative resources and hence does not fall under the scope exclusion in paragraph 2(d) of Ind AS 38.

In view of the above, mining lease rights under discussion should be accounted for under Ind AS 38.

As regards the manner of amortisation of the mining rights (i.e., whether period-based or quantity-based), Ind AS 38 requires the depreciable amount of an intangible asset with a finite useful life to be allocated on a systematic basis over its useful life. The term ‘useful life’ is defined as:

- (a) *the period over which an asset is expected to be available for use by an entity; or*

(b) the number of production or similar units expected to be obtained from the asset by an entity.

Ind AS 38 requires that the amortisation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. If that pattern cannot be determined reliably, the straight-line method shall be used. The Standard recognises that a variety of amortisation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the units of production method. The method used is selected on the basis of the expected pattern of consumption of the expected future economic benefits embodied in the asset and is applied consistently from period to period, unless there is a change in the expected pattern of consumption of those future economic benefits.

Ind AS 38 also notes that in choosing an appropriate amortisation method, an entity could determine the predominant limiting factor that is inherent in the intangible asset. For example, the contract that sets out the entity's rights over its use of an intangible asset might specify the entity's use of the intangible asset as a predetermined number of years (i.e. time), as a number of units produced or as a fixed total amount of revenue to be generated. Identification of such a predominant limiting factor could serve as the starting point for the identification of the appropriate basis of amortisation, but another basis may be applied if it more closely reflects the expected pattern of consumption of economic benefits.

It would be noted from the above that selection of an appropriate amortisation method for the mining lease requires consideration of the exact facts and circumstances of the case. Therefore, this assessment will need to be made by the entity itself in the light of its detailed and in-depth knowledge of the facts and circumstances of its particular case.

Issue 4: ABC Limited is a pharmaceutical company. As a part of its sales promotion activities, it distributes gifts (mobile phones, decorative items and the like) along with its product catalogues to doctors to encourage them to prescribe medicines manufactured by it. No conditions are attached with the items distributed.

Would the distribution of gifts to doctors be covered by Ind AS 115, *Revenue from Contracts with Customers*? If not, how should the same be accounted for by ABC Limited?

Response:

Paragraph 6 of Ind AS 115, *Revenue from Contracts with Customers*, states as follows:

“6 An entity shall apply this Standard to a contract (other than a contract listed in paragraph 5) only if the counterparty to the contract is a customer. A customer is a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration....”

The term 'contract' is defined in Ind AS 115 as follows:

An agreement between two or more parties that creates enforceable rights and obligations.

In the given case:

- Gifts are distributed by ABC Limited to doctors as a part of its sales promotion activities without there being an agreement between ABC Limited and the doctors creating enforceable rights and obligations.
- The doctors to whom gifts are distributed are not ‘customers’ of ABC Limited – they have not contracted with it to obtain goods or services in exchange for consideration.
- The items distributed as gifts are not an output of ABC Limited’s ordinary activities.

In view of the above, the distribution of gifts to doctors does not fall under the scope of Ind AS 115.

Paragraph 5 of Ind AS 38, *Intangible Assets, inter alia*, states that, “this Standard applies to, among other things, expenditure on advertising, training, start-up, research and development activities”. Paragraph 48 of Ind AS 38 states that internally generated goodwill shall not be recognised as an asset. Paragraphs 63 and 64 of Ind AS 38 preclude an entity from recognising internally generated brands, mastheads, publishing titles, customer lists and items similar in substance as intangible assets on the basis that expenditure on such internally generated items cannot be distinguished from the cost of developing the business as a whole. Further, paragraphs 69 and 69A of Ind AS 38 state as follows:

“69 In some cases, expenditure is incurred to provide future economic benefits to an entity, but no intangible asset or other asset is acquired or created that can be recognised. In the case of the supply of goods, the entity recognises such expenditure as an expense when it has a right to access those goods..... Other examples of expenditure that is recognised as an expense when it is incurred include

.....

(c) expenditure on advertising and promotional activities (including mail order catalogues).....”

“69A An entity has a right to access goods when it owns them. Similarly, it has a right to access goods when they have been constructed by a supplier in accordance with the terms of a supply contract and the entity could demand delivery of them in return for payment. Services are received when they are performed by a supplier in accordance with a contract to deliver them to the entity and not when the entity uses them to deliver another service, for example, to deliver an advertisement to customers.”

Items acquired by ABC Limited to be distributed as gifts as a part of sales promotion activities have no other purpose than to undertake those activities. In other words, the only benefit of those items for ABC Limited is to develop or create brands or customer relationships, which in turn generate revenue. Paragraph 69 of Ind AS 38 requires an entity to

recognise expenditure on such items as an expense when the entity has a right to access those goods. Paragraph 69A of Ind AS 38 states that an entity has a right to access goods when it owns them, or otherwise has a right to access them regardless of when it distributes the goods

In view of the above, ABC Limited should recognise the expenditure on items to be distributed as gifts as an expense when it owns those items, or otherwise has a right to access them, regardless of when it distributes the items to doctors.

Issue 5: ABC Limited merges into PQR Limited and the merger meets the definition of a ‘common control business combination’ as per Appendix C of Ind AS 103, *Business Combination*. As per the scheme approved by the competent authority (National Company Law Tribunal, or NCLT) in this regard, the appointed date for the merger is April 1, 2016. The NCLT’s order approving the scheme was received on March 27, 2019.

PQR Limited has been applying Ind ASs w.e.f. financial year beginning April 1, 2016. Thus, its date of transition to Ind ASs (within the meaning of this term under Ind AS 101, *First-time Adoption of Indian Accounting Standards*) is April 1, 2015.

Whether the comparatives are required be given only for one year (i.e. for the year ended on March 31, 2018) or whether a third balance sheet as of April 01, 2017 is also required to be presented as part of financial statements of PQR Limited for the year ended March 31, 2019?

Response:

Paragraph 10 of Ind AS 1, *Presentation of Financial Statements* states as follows:

“10 A complete set of financial statements comprises:

(a)

(f) a balance sheet as at the beginning of the preceding period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements in accordance with paragraphs 40A–40D.”

In the given case, there is change in composition of the reporting entity and not the retrospective application of an accounting policy, retrospective restatement or retrospective reclassification.

Further, paragraph 9 of Appendix C of Ind AS 103 states as follows:

“9 The pooling of interest method is considered to involve the following:

(i)....

(iii) The financial information in the financial statements in respect of prior periods should be restated 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. However, if business combination had occurred after that date, the prior period information shall be restated only from that date.”

Ind AS 103 Appendix C requires only restatement of comparative information and does not require a third balance sheet at the beginning of the preceding period (unless the beginning of the preceding period also happens to be the date of transition to Ind ASs in a particular case).

In accordance with the above requirements, the financial statements are required to be restated for the year 2018-19 with comparative for 2017-18.

Issue 6: Entity B and Entity C are both under the control of Entity A. Entity B and Entity C filed a scheme of arrangement with NCLT in the year 2017. Pursuant to the scheme, one of the business divisions of Entity B was to be demerged and merged with Entity C. 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 March 31, 2019. The appointed date of merger as per the scheme April 1, 2018. Both entities, Entity B and Entity C will prepare their first Ind AS financial statements for year ended March 31, 2018.

- (i) Whether the financials of the Entity C for the financial year 2017-18 should be restated in accordance with paragraph 9(iii) of Appendix C to Ind AS 103, *Business Combination*, considering that the appointed date of the merger is April 1, 2018?**
- (ii) Whether the financials of Entity B (demerged entity) for the financial year 2017-18 should be restated, considering that Ind AS 103 is not applicable to the demerged entity.**

Response:

Paragraph 9 of Appendix C of Ind AS 103 states as follows:

“9 *The pooling of interest method is considered to involve the following:*

(i)....

(iii) The financial information in the financial statements in respect of prior periods should be restated 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. However, if business combination had occurred after that date, the prior period information shall be restated only from that date.”

In accordance with paragraph 9(iii) above, C Limited is required to prepare its financial statements (including comparative information presented therein) for the year ended March 31, 2019 as if the transfer of the division had occurred from the beginning of the comparative

period presented in the financial statements for the year ended 31 March 2019 i.e., April 1, 2017, notwithstanding the appointed date of 1 April 2018 specified in the scheme.

Appendix C to Ind AS 103 lay 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, Entity B 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*.

Issue 7: Entity A, which prepares its financial statements as per Ind ASs obtained a loan from one of its directors during the year 2015-16 which is still outstanding as at the end of year 2018-19. The loan is not related to a qualifying asset and is repayable on demand. In previous years, the interest was charged and paid to the directors. However, in respect of interest on the loan for the year, 2018-19, a waiver was obtained from the director without amendment of the loan agreement.

What should be the accounting treatment of interest on the loan for the year 2018-19?

Response:

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

Paragraph 15 of Ind AS 1, *Presentation of Financial Statements*, states as follows:

“Financial statements shall present a true and fair view of the financial position, financial performance and cash flows of an entity. Presentation of true and fair view requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework. The application of Ind ASs, with additional disclosure when necessary, is presumed to result in financial statements that present a true and fair view.”

As per the facts of the case, Entity A is contractually required to pay interest on the loan obtained by it from a director but the same is waived by the director. As per paragraph 15 of Ind AS 1 stated above, presentation of true and fair view requires the faithful representation of the effects of transactions, other events and conditions. To achieve fair presentation, it is appropriate that Entity A recognises its contractual obligation for payment of interest as well as the waiver thereof by recognising 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.
