



**ACCOUNTING AND COMPANY LAW**

# N. A. SHAH **BULLETIN**

**October & November 2017**

**N. A. SHAH ASSOCIATES LLP**  
Chartered Accountants



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## EXECUTIVE SUMMARY

- **Accounting**

- The Institute of Chartered Accountants of India (ICAI) has issued an expert advisory opinion on whether the accounting treatment to capitalize the cost of utility diversions, environmental protection, road diversions / restoration / signages, renovation work of drainage system, rehabilitation and resettlement etc. which are compulsorily required to be incurred for construction of Mass Rapid Transit System (MRTS) project, is in line with the provisions of AS 10- Fixed Assets.

As per the opinion, the Committee is of the view that the treatment would depend upon the nature of each item of expenditure and whether such expenditure can be considered to be directly attributable to the construction of project / fixed asset. Otherwise, these expenditure are charged to statement of profit and loss.

Treatment of funds received from the Government of India (GoI) and Government of National Capital Territory of Delhi (GNCTD) towards financing of such specified expenditure would depend upon whether the funds received are of the nature of equity contribution or in the form of Government Grant or debt to the Company.

- Accounting Standards Board, ICAI (Board) has issued two exposure drafts on revision in existing Accounting Standards (a) AS 23- Borrowing Costs and (b) AS 24- Related Party Disclosures.

- **Company Law**

- MCA has notified section 247 relating to valuation by registered valuers and the relevant rules and are applicable w.e.f. 18-Oct-17.
- Last date for filing of AOC-4 for FY 16-17 is extended to 31-Mar-18 for Companies complying with Ind AS and was extended to 28-Nov-17 in other cases, without payment of additional fee. Further, Form AOC-4 has been revised.
- Exemption is withdrawn in case of Power Sector Companies from filing of financial statements in XBRL utility w.e.f. date of publication in the official gazette.
- Rule 6 and 7 of the Investor Education and Protection Fund Authority (Accounting, Audit, Transfer and Refund) Rules, 2016, in respect of transfer of shares to the fund have been amended.

- **Indian Accounting Standards (Ind AS)**

- The Ind AS Transition Facilitation Group (ITFG) of the ICAI has issued 'Bulletin 5' providing clarification on various issues related to applicability and/or implementation of Ind AS under the Companies (Accounting Standard) Rules, 2015.

**1. Accounting**

**1.1 Expert Advisory Opinion**

Accounting treatment of expenditure relating to cost of utility diversions, environmental protection, road diversions / restoration / signages, renovation work of drainage system, rehabilitation and resettlement etc. (hereinafter referred to as "specified expenditure") which are compulsorily required to be incurred for construction of Mass Rapid Transit System (MRTS) project.

**a. Facts of the case**

- Ministry of Urban Development (MoUD) has given an investment approval for MRTS Phase III project based on Detailed Project Report (DPR), funding of which is arranged by Government of India (GoI) and Government of National Capital Territory of Delhi (GNCTD). The total cost of the project includes the specified expenditure.
- The Company is engaged in construction of MRTS project and has accounted the specified expenditure under the head Capital work-in-progress ('CWIP').
- In this connection, C&AG stated that the specified expenditure should be charged off to revenue in the year of incurrence instead of capitalizing it based on the following reasons:
  - As per the accounting policy of the Company, "expenditure on items, ownership of which is not with the Company is charged off to revenue". As the specified expenditure are incurred on land not owned by the Company, classifying the same as CWIP is not in accordance with the accounting policy.
  - Though the specified expenditure incurred is incidental to construction since, the Company does not have exclusive rights over the use of such assets, the specified expenditure do not qualify as an 'asset' (para 49 of the Framework for Preparation and Presentation of Financial Statements).
  - One of the expert advisory opinion, the expenditure incurred on enabling assets (assets which facilitates the construction of project, the ownership of which does not vest with the Company) cannot be capitalized as a separate tangible asset. (Query No. 2 of Volume XXX of Compendium of Opinions).

- As per the Company, construction of MRTS project could not have taken place without the incurrence of these specified expenditures and the project could not be brought to its working condition. No separate asset item in the nature of enabling asset is created. These activities are ancillary type of activities which are required to be completed before completion of MRTS project.

EAC (Query no. 6 of Volume XXXIII of Compendium of Opinions) had opined that the basic principle to be applied while capitalizing an item of cost to a fixed asset under construction is that it should be directly attributable to the construction of the fixed asset for bringing it to its working condition for its intended use and without the incurrence of which, the construction of fixed asset could not have taken place. The Company has consistently followed the same practice in Phase I and Phase II of MRTS project.

**b. Query**

Whether the accounting treatment to capitalize the cost of specified expenditure is in line with the provisions of AS 10- Fixed assets. If not, what is the alternative accounting treatment available with the Company regarding treatment of such specified expenditure and also treatment of funds received by the Company from Gol and GNCTD towards financing of such specified expenditure.

**c. Points considered by the Committee**

- The Committee has presumed that the MRTS project is owned and controlled by the Company and the Company is not acting only as an implementing / executing agency of the Government. The issue raised in the extant case is with regard to accounting treatment of the aforementioned expenditure and not whether the same are of the nature of 'enabling asset'.
- From a holistic reading of the paragraphs of 9.1, 9.2, 10.1, 20 and 21 of AS 10, the Committee noted that an item of cost should be capitalized with the cost of a fixed asset / project under construction only when it is directly attributable to the construction of the project / fixed asset for bringing it to its working condition for its intended use. Further, it should not merely be incidental to the construction activity or only agreed to be incurred as a part of the MOU or agreement with the Government while approving the construction project. If an expenditure, say on road diversion / utility diversion, the diversion work is in the nature of site preparation activity of

the MRTS project / fixed asset, the same can be considered to be directly attributable to the construction of the MRTS project / fixed asset and therefore, capitalized as a part of the cost of MRTS project /fixed asset.

**d. Opinion**

- The Committee is of the following opinion:
  - Whether the treatment made by the Company to capitalize the expenditure incurred on the construction of MRTS project is in accordance with AS 10 or not, would depend upon the nature of each item of specified expenditure and whether such expenditure can be considered to be directly attributable to the construction of MRTS project.
  - If the specified expenditure is not directly attributable to the construction, then the same should be charged to statement of profit and loss in the year of incurrence of such specified expenditure.
  - Treatment of funds received from the GoI and GNCTD towards financing of such specified expenditure would depend upon whether the funds received are of the nature of equity contribution or in the form of Government Grant or debt to the Company. In the absence of specific details with respect to this, the Committee has not expressed its views in respect of the same.

Note: The opinion expressed by EAC is from the perspective of accounting requirements contained in the Companies (Accounting Standards) Rules, 2006 [Accounting Standard (AS) 10- Fixed Assets]. AS 10 has been replaced by Accounting Standard 10 – Property Plant & Equipment which was amended by the MCA vide Notification dated March 30, 2016 & is applicable to corporate entities for the accounting period commencing on or after the date of such Notification.

**1.2 Accounting Standards**

Accounting Standards Board, ICAI (Board) has issued two exposure drafts on:

- AS 23- Borrowing Costs and;
- AS 24- Related Party Disclosures

Accounting Standards notified under the Companies (Accounting standards) Rules, 2006 are being modified to bring them nearer to Indian Accounting Standards. The Board has decided to maintain the consistency with the numbering of Standards of the Ind AS, consequently existing accounting standard numbers are also revised.

**2. Company Law**

**2.1 Valuation by registered valuers**

- MCA has notified section 247 relating to valuation by registered valuers and the relevant rules w.e.f. 18-Oct-17.
- Considering the difficulty faced to ensure the required level of regulation for the valuers by registering them directly with the Central Government (CG), the CG has made Companies (Removal of difficulties) Second Order, 2017.

Old Rule	New Rule
A person having such qualifications and experience and registered as a valuer, in such manner, on such terms and conditions as may be prescribed.	A person having such qualifications and experience, registered as a valuer and <u>being a member of an organization recognized</u> , in such manner, on such terms and conditions as may be prescribed.

- Any person rendering valuation services under the Act, on the date of commencement of these rules, may continue to render valuation services without a certificate of registration upto 31-Mar-18. If a valuer was appointed before such date and the valuation or any part of it has not been completed before 31-Mar-18, the valuer shall complete it within 3 months.
- Other matters have been prescribed in respect of eligibility, qualifications, experience and examination to register as valuer and procedural matter for application & conditions for certificate of registration.
- Powers and functions vested to Central Government by section 247 have now been delegated to the Insolvency and Bankruptcy Board of India.

**2.2 Last date for filing of AOC-4 for FY 2016-17 has been extended**

Due date of e-filing of AOC -4 in respect of filing of annual return has been extended as under:

- Till 31-Mar-18 for Companies complying with Indian Accounting Standards and are required to file in XBRL format without additional fee.
- Till 28-Nov-17 in other cases without additional fee.

**2.3 Withdrawal of exemption and amendment in from XBRL utility**

Exemption to Power Sector Companies from filing of financial statements has been withdrawn under Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Amendment Rules, 2017 which will be effective from date of publication in the Official Gazette.

## 2.4 Changes in IEPF Authority (Accounting, Audit, Transfer and Refund) Rules

The new rules may be called Investor Education and Protection Fund Authority (Accounting, Audit, Transfer and Refund) Second Amendment Rules, 2017 which will be effective from 13-Oct-17. Summary is as under:

- **Amendment in second proviso to sub-rule 1**

Due date of transfer of shares to IEPF by the Companies, in case where period of seven years provided u/s 124(5) has been completed or being completed during the period from 7-Sep-16 to 31-Oct-17, was extended to 31-Oct-17.

- **Insertion of third proviso to sub-rule 1**

Transfer of shares by the Companies to the Fund shall be deemed to be transmission of shares and all the corresponding procedures shall be followed.

- **Changes in clause d** (For the purposes of effecting the transfer shares held in physical form) **of sub-rule 3:**

- New share certificate to be issued instead of duplicate share certificate.
- Form No. SH-1 instead of Form No. SH-2 shall be used for particulars of every share certificate to be specified as per the respective rules.

- **Two new sub-rules are inserted:**

- **Sub-rule 13:** Any amount should be remitted into the specified account of the IEPF authority maintained in the Punjab National Bank.
- **Sub-rule 14:** IEPF authority should report to Central Government in case of non-compliance by the Company.

- Other procedural changes have been made in rule 7 regarding nomination of Nodal Officer for the purpose of coordination with IEPF authority.

### 3. Indian Accounting Standards

#### 3.1 ITFG Bulletin 12

##### Issues and Answers

##### Issue no. 1 (i):

A Company covered under phase II of Ind AS roadmap is required to apply Ind AS from FY 17-18. Whether the Company is allowed to use revaluation model under Ind AS 16 "Property, Plant and Equipment" for immovable properties (land and building) instead of cost model in its first Ind AS financial statements prepared for the period ending 31-Mar-18?

##### Reply:

- a) An entity will first be required to evaluate that whether the immovable properties (land of building or part of building or both) that it holds is an investment property or its Property, Plant and Equipment (PPE).
- b) If immovable properties are classified as PPE, then the same shall be initially measured at cost and for subsequent measurement the entity has the option to choose cost model or revaluation model as per paragraph 29 of Ind AS 16.
- c) However, if immovable properties have been held to earn rentals or for capital appreciation or both, then the same shall be classified as investment property and only cost model as per paragraph 30 of Ind AS 40 can be used.

##### Issue no. 1 (ii):

Whether the Company can opt for cost model for some class of PPE and apply revaluation model for other class of PPE in its first Ind AS financial statements prepared for the period ending 31-Mar-18.

##### Reply:

- a) Paragraphs 36 and 37 of Ind AS 16 requires that if revaluation model is chosen then that should be applied to the entire class and not to an individual item of PPE.
- b) Accordingly, in the given case, the entity may elect to opt for revaluation model for a particular class of assets and cost model for another class of assets which are classified as PPE.

##### Issue no. 2:

A Company which is first time adopter of Ind AS from FY 16-17 has received Government Grant from Central Government (CG) during FY 12-13 to purchase fixed asset. The grant received was deducted from the carrying amount of fixed asset as permitted under previous GAAP. The Company had chosen to measure the item of PPE at its fair value and use that as its deemed cost on the date of transition to Ind

AS. Whether the Company is required to adjust the carrying amount of fixed assets as per previous GAAP to reflect accounting treatment of the Government Grant as per Ind AS 20?

**Reply:**

- a) Para D5 of Ind AS 101 states that, An entity may elect to measure an item of PPE at the date of transition to Ind AS at its fair value and use that fair value as its deemed cost at that date.
- b) The fair value of the asset that will be derived as per Ind AS 113 will be the exit price that would be received to sell an asset in an orderly transaction and which is a market-based measurement, not an entity-specific measurement.
- c) Accordingly, in the given case, fair value of the asset is independent of the Government Grant received on the asset and no adjustment with regard to the Government Grant should be made to the fair value of the PPE taken as deemed cost on the date of transition to Ind AS.
- d) Ind AS 101 provides certain mandatory exceptions and voluntary exemptions from retrospective application of some aspects / requirements of Ind AS. In absence of any mandatory exception applicable in this case in Ind AS 101, the Company shall recognize the asset-related government grants outstanding on the transition date as deferred income in accordance with the requirements of Ind AS 20 and the resultant adjustment will be made in retained earnings or, if appropriate, another category of equity at the date of transition to Ind AS.

**Issue no. 3:**

P Limited (parent company) has issued a comfort letter to its subsidiary company S Limited. S Limited was able to obtain funds from the banker on the basis of comfort letter issued by P Limited.

Whether the same will be accounted for as a financial guarantee contract in accordance with Ind AS 109 "Financial Instruments"?

**Reply:**

- a) A significant feature of a financial guarantee contract is the contractual obligation to make specified payment in case of default by the credit holder. As such the contract may not necessarily be called as financial guarantee contract and it may take any name or legal form, however the treatment will be same as that of a financial guarantee contract. If a contract legally meets these requirements, then it would be accounted for as the financial guarantee contract as per Ind AS 109.
- b) Accordingly, in the given case, P Limited will be required to evaluate as to whether it is contractually obliged to make good the loss in case S Limited fails to make the payment. If yes, then such comfort letter would be considered

to be a financial guarantee contract and will be accounted for in accordance with Ind AS 109.

**Issue no. 4:**

A Company covered in phase II of Ind AS implementation has obtained loan from Bank A in FY 13-14 and paid processing fee and commitment charges. In May 2017, it has availed fresh loan from Bank B to pay-off the old loan and has paid prepayment premium to Bank A and processing fee to Bank B.

Whether the prepayment premium and the processing fees both will be treated as transaction cost (as per Ind AS 109 "Financial Instruments") of obtaining the new loan, in the financial statements of PQR Ltd. prepared in accordance with Ind AS for the FY 17-18.

**Reply:**

- a) It is assumed that the loan processing fees solely relates to the origination of the new loan (i.e. does not represent loan modification / renegotiation fees). In accordance with paragraph B5.4.8, B5.4.2 and definition of incremental cost as per Appendix A of Ind AS 109, the processing fees paid to avail fresh loan from Bank B will be considered as transaction cost in the nature of origination fees of the new loan and will be included while calculating effective interest rate as per Ind AS 109.
- b) Since the original loan was prepaid, the prepayment would result in extinguishment of the original loan. As per paragraph 3.3.3 of Ind AS 109, the difference between the carrying amount of the financial liability extinguished and the consideration paid shall be recognised in profit or loss. Further as per paragraph B3.3.6 of Ind AS 109, the prepayment premium shall be recognised as part of the gain or loss on extinguishment of the old loan. Further, the unamortized processing fee related to the old loan will also be required to be charged to the statement of profit and loss.

**Issue no. 5:**

X Ltd. a first time adopter of Ind AS & A Ltd. is an associate company of X Ltd. under previous GAAP. A Ltd. was consolidated in X Ltd. under equity method. A Ltd. became its subsidiary considering the principles of de-facto control as per the requirements of Ind AS 110 "Consolidated Financial Statements".

Before transition to Ind AS, X Ltd. had sold goods to A Ltd. at profit margin of 10%, which is recorded by A Ltd. as PPE for A Ltd. X Ltd. has chosen to continue with carrying value of PPE as per the previous GAAP which requires the values appearing in the subsidiary's financial statements to be taken without any adjustment. Will such unrealised profits existing in the PPE at consolidated level require elimination?

**Reply:**

As per combined reading of para D7AA of Ind AS 101 and para B86 of Ind AS 110, in the given case X Ltd. in its consolidated financial statements will first eliminate the intra group profit of 10% recognised in separate financial statements of A Ltd. and then will apply the deemed cost exemption under paragraph D7AA of Ind AS 101.

**Issue no. 6:**

ABC & Co. incorporated in US with limited liability, has established a branch office in India to provide consultancy services in India. The branch office remits the amounts earned by it to ABC & Co. (i.e. Head office) net of applicable taxes and subject to RBI guidelines. As on April 1, 2016, branch office has more than Rs. 500 crore balance as "HO account".

Whether the India branch office of ABC Co. will be required to comply with Ind AS?

**Reply:**

- a) A Company as defined under section 2(20) of The Companies Act, 2013 is required to comply with Ind AS. A "Company" means a Company incorporated under this Act or under any previous Company law.
- b) The branch office of a foreign company established in India is not incorporated under the Act. The Branch office is just an extension of the foreign company in India.
- c) Further, it may be noted that Branch office of a foreign company is not covered under rule 6 of the Companies (Indian Accounting Standards) Rules, 2015. Accordingly, in the given case, the branch office of ABC & Co. is not required to comply with Ind AS.

**Issue no. 7(i) :**

P Ltd. has obtained a below market rate of interest loan of INR 10,00,000 from Government as on 1-Apr-14 for 5 years. The date of transition to Ind AS for P Ltd. is 1-Apr-16. Para B10 of Ind AS 101, First-time Adoption of Ind AS provides to use previous GAAP carrying amount of Government loans existing at the date of transition to Ind AS as the Ind AS carrying amount of such loans at that date.

The carrying amount was INR 10,00,000 at the date of transition to Ind AS. The amount repayable will be INR 10,05,000 at 1-Apr-19. No other payment is required under the terms of the loan and there are no future performance conditions attached to the loan. Whether the exemption under paragraph B10 is only for the date of transition to Ind AS or all the subsequent period till the existing loan is presented i.e. 31-Mar-19.

**Reply:**

- a) A first-time adopter is required to use its previous GAAP carrying amount of government loans existing at the date of transition to Ind AS, as the Ind AS

carrying amount of such loans at that date. A first-time adopter applies Ind AS 32 to classify such a loan as a financial liability or an equity instrument. It shall apply the requirements of Ind AS 20 and Ind AS 109 prospectively to government loans existing at the date of transition to Ind AS, unless the necessary information needed to apply the requirements of Ind AS 109 and Ind AS 20, retrospectively was obtained at the time of initially accounting for that loan. As a result of not applying Ind AS 20 and Ind AS 109 retrospectively to government loans at the date of transition, the corresponding benefit of the Government loan at a below-market rate of interest is not recognised as a Government Grant.

- b) In the given case, as per Ind AS 32, the loan meets the definition of a financial liability. P Ltd. uses the previous GAAP carrying amount of the loan at the date of transition to Ind AS as the carrying amount of the loan in the opening Ind AS Balance Sheet. Further in order to measure the loan after the date of transition to Ind AS, the effective interest rate starting from 1-Apr-16 shall be calculated.

**Issue no. 7 (ii):**

Further P Ltd., also has deferment of liability payable to government based on agreement i.e. liability similar to sales tax deferment for 10 years, can P Ltd. take exemption under B10 stating it is similar to government loan?

**Reply:**

- a) The manner in which a grant is received does not affect the accounting method to be adopted in regard to the grant. Thus a grant is accounted for in the same manner whether it is received in cash or as a reduction of a liability to the Government.
- b) In a scheme of deferral of sales tax, the amount of sales tax collected by the Company from its customers is retained by the Company and is required to be repaid after specified years (10 years in this example). This makes such an arrangement similar in nature to an interest free loan & hence the treatment as mentioned in part 7(i) (a) & (b) above shall also be applied to such balances outstanding at the date of transition.

**Issue no. 8:**

Company A holds 100% shareholding of Company B who in turn holds 100% shareholding of Company C. Pursuant to a court scheme, to be filed in February 2018, Company C will merge with Company B during the FY 18-19 (i.e. the scheme is expected to be approved during the FY 18-19). All Companies (A, B and C) are covered under Phase II of Ind AS and will prepare financial statements for year ending 31-Mar-18 as per Ind AS. In case the appointed date in the scheme is 1-Apr-16, would it have any impact on the certificate to be issued by the auditors on compliance of the scheme with Ind AS 103? Would the response be different in case the transferor and transferee Company are not under common control?

**Reply:**

- a) As per para 8 & 9 of Ind AS 103 "Business Combinations", the acquirer shall identify the acquisition date, which is the date on which it obtains control of the acquiree. Ind AS 103 prescribes significantly different accounting for business combinations which are not under common control and those under common control. Accordingly, entity is required to assess whether the business combination is under common control or not.
- b) In case business combination is under common control:  
In accordance with paragraph 9(iii) of Ind AS 103, the entity will be required to restate its financial statements as if the business combination had occurred from the beginning of the preceding period.
- c) In case business combinations is other than that under common control:  
The date of acquisition will be the date from which the acquirer obtains control of the acquiree. The response of auditor shall remain the same as per paragraph (b) above.
- d) In cases where the auditor is of the view that as per the proposed accounting treatment, effective date of amalgamation as per the books of account of the amalgamated company is different from the acquisition date as per the Standard i.e. date on which control has been actually transferred, the auditor shall state the facts in the certificate as per the proviso to Section 232 (3) of the Companies Act, 2013.

If the NCLT approves the scheme with a different appointed date as compared to the acquisition date as per Ind AS 103, the appointed date as approved by the NCLT under the scheme will be the acquisition date. In this situation, the company should provide appropriate disclosures and the auditor should consider the requirements of relevant auditing standards.

**Issue no. 9:**

Company A is covered under Phase II of Ind AS roadmap and is required to apply Ind AS from financial Year 2017-18. Company A acquired Company B as per the scheme of amalgamation sanctioned under the provisions of the Companies Act, 2013. The amalgamation was effective from 1st April, 2015 and was accounted for in the financial year 2015-16 under Indian GAAP. As per the Scheme, the entire undertaking of Company B including all its assets, liabilities and reserves and surplus stood transferred in Company A. As a result, Company A has taken over assets /liabilities including certain financial instruments.

Under Ind AS, Company A has opted for option under paragraph C1 of Ind AS 101, First-time Adoption of Indian Accounting Standards, not to apply Ind AS 103 retrospectively to past business combinations (business combinations that occurred before the date of transition to Ind AS).

Whether Company A would be required to apply Ind AS 109, Financial Instruments

retrospectively (i.e. from the date of origination of the financial instrument by Company B) to such financial instruments acquired as part of the business combination?

**Reply:**

- a) Considering para C1 and C4 of Ind AS 101, it may be noted that it provides an option to not to apply Ind AS retrospectively to business combinations that occurred before the date of transition to Ind AS. If previous business combinations are not restated, the previous acquisition accounting remains unchanged. Carrying amount under previous GAAP of assets acquired and liabilities assumed in an un-restated business combination immediately after the business combination becomes their deemed cost at that date.
- b) Further, unless there is a transitional relief under Ind AS 101 for financial instruments, the requirements of Ind AS 109 need to be applied retrospectively. Ind AS 101 does not provide for any transitional relief for financial instruments and requires applying requirements of Ind AS 109 retrospectively. However, Ind AS 101 specifically provides guidance with regard to treatment to be done if entity elects to opt not to restate past business combinations. Accordingly, if financial instruments have been acquired as part of the business combinations, then requirements of Appendix C to Ind AS 101 shall apply.
- c) Fair value or amortised cost (as required by Ind AS 109) shall be determined from the date of business combination and not from the date of origination of such financial instrument by Company B.
- d) If financial instruments are classified as FVTPL / FVOCI, then these should be measured at fair value at the date of transition to Ind AS.
- e) If financial instruments are classified at amortised cost, then the Company determines the carrying amount on the transition date by taking the carrying amount of the loan at the date of business combination under previous GAAP and apply the effective interest rate which is determined after considering the amount and timing of expected settlement of such financial instrument.

**Issue no. 10:**

On the date of transition, an entity has elected to measure its assets and liabilities at its deemed cost in accordance with previous GAAP carrying value as permitted under Ind AS 101 "First-time Adoption of Indian Accounting Standards" in the opening Ind AS Financial Statements. Whether any adjustments arising due to application of other Ind AS is to be made to the previous GAAP carrying amount on the date of transition, if this exemption is availed?

**Reply:**

- a) In view of definition of deemed cost and para 10 of Ind AS 101, except any

specific exemption / exception as laid out in Ind AS 101, all the assets and liabilities are required to be recognised in accordance with the principles of Ind AS 101.

- b) In cases where no exemption / exception has been provided in respect of an item of asset and/or liability; however, application of Ind AS principles has a corresponding impact on another item of asset and / or liability in respect of which Ind AS 101 permits carry forward of previous GAAP amounts as at the transition date, then such cases will be considered only as consequential and arising because of application of the transition requirements of Ind AS 101 and thereby the previous GAAP carrying amount needs to be adjusted only to this extent.

It may be noted that except such situations, no further adjustment should be made due to application of other Ind AS, if an entity measure its assets and liabilities at its deemed cost in accordance with previous GAAP carrying value as permitted under Ind AS 101 on the date of transition. Please also refer Issue No. 4 and Issue No. 5 of ITFG Clarification Bulletin 5 and Issue no. 1 of ITFG Clarification Bulletin 10.

**Issue no. 11 (i):**

A Company is covered under Phase II of Ind AS roadmap applicable from FY 17-18, has given financial guarantee for five years against the loan taken by its associate company since 1-Apr-14 and charging 1% guarantee commission.

- (i) At what value will the financial guarantee contract be accounted for in the opening Ind AS balance sheet of the Company?

**Reply:**

- a) Presuming that the financial guarantee meets the definition of financial guarantee contract as per Ind AS 109, if the associate company pays the parent company a guarantee commission, the parent company is required to determine if this commission represents the fair value of the financial guarantee contract.
- b) If the premium is equivalent to an amount that associate company would have paid to obtain a similar guarantee in a standalone arm's length transaction, then at the initial recognition the fair value of the financial guarantee contract is likely to equal the commission received.

**Issue no. 11(ii):**

Further, if on 31-Mar-16, the guarantee is invoked but V Ltd. has shown it under contingent liability in financial statement of 2015 and also 2016 contesting that it is confident that liability shall not devolve on it. Whether on transition date i.e. 1-Apr-16 the impairment need to be calculated and accordingly fair value of financial guarantee need to be calculated?

**Reply:**

- a) As per paragraphs 4.2.1 and 5.5.1 of Ind AS 109, V Ltd. should recognise a liability for the amount of premium received and subsequently measure the financial guarantee contract at the higher of the amount of loss allowance determined in accordance with Ind AS 109 and the amount initially recognised less cumulative amount of income recognised in accordance with Ind AS 18 "Revenue".
- b) In accordance with the above, at the end of each reporting period the entity shall estimate and recognise the expected loss in accordance with the provisions prescribed in the standard. Accordingly in the given case, V Ltd. shall estimate and recognise the same in accordance with Ind AS 109.

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