ACCOUNTING AND COMPANY LAW

N. A. SHAH

BULLETIN

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Chartered Accountants

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    - Amendments to Indian Accounting Standards (Ind AS) which are effective for accounting periods beginning on or after 1st April 2018 and these amendments are to align with the changes made in corresponding IFRS.
        - Ind AS 40, Investment property
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    - Ind AS 115- Revenue from Contracts with Customers which is effective for accounting periods beginning on or after 1st April 2018.
    - Ind AS Transition Facilitation Group (ITFG) of Ind AS Implementation Committee has issued Bulletin 15 which provides clarifications on various issues related to applicability and/or implementation of Ind AS.
- **Company Law**
    - Provision notified related to related to constitution of National Financial Reporting Authority. It is notified that 21st March 2018 is the effective date for Section 132(3) and (11) of the Companies Act 2013.

1 Accounting

1.1 Expert Advisory Opinion

Amortisation of expenses incurred on various business requirements at the time of formation

a. Facts of the case

A company was incorporated under the Companies Act, 2013 in July, 2015. During November 2015, the company incurred an expenditure of Rs. 92.92 lakh which comprises of Rs. 76.34 lakhs towards fees paid to Registrar of Companies (ROC) for authorised share capital, professional fee paid Rs. 12.97 lakhs, preliminary expenses paid to lawyers and accountants Rs. 3.61 lakhs. The Company classified total amount under 'Preliminary Expenses' and amortised it over five years.

However, as per the Comptroller & Auditor General of India (C&AG), these expenses are in the nature of preliminary expenses incurred prior to incorporation for the purpose of formation of the company and should be charged off in the same year of incidence. This is considering Accounting Standard (AS) 26, 'Intangible Assets', according to which preliminary expenses needs to be recognised as an expense when it is incurred.

b. Query

Whether under the given circumstances, the company can amortise the expenses, mainly relating to fee paid to the Ministry of Corporate Affairs and incidental legal fee], professional fee etc. paid at the time of formation.

c. Points considered by the committee

As per the Guidance note (GN) on Terms Used in Financial Statements, issued by ICAI, share issue expenses means costs incurred in connection with the issue and allotment of shares. These include legal and professional fees, advertising expenses, printing costs, underwriting commission, brokerage, and also expenses in connection with the issue of prospectus and allotment of shares. Therefore, fee paid for authorised share capital is not covered in the definition of 'share issue expenses'.

In view of the committee, registration of authorised share capital is a necessary step to set a limit for the paid up capital of a company at any given point of time and cannot be termed as 'share issue expense'. Issuance of shares is a separate independent process subsequent to the registration of authorised capital and the same can be done at a later stage as well.

As regards accounting for the expenses incurred on ROC Fees, professional fees and preliminary expenses paid to lawyers, the Committee referred to paragraphs 6.2 & 56 of AS 26. Accordingly, if expenditure does not result into acquisition of an asset, it should be recognised as an expense as and when incurred. These expenses does not give rise to any resource controlled by the enterprise. In fact, such expenses are in the nature of start-up costs/preliminary expenses, which are only related to incorporation of the company and set a limit for the issued/paid-up capital of the company which does not ensure any flow of funds to the company. Accordingly, it does not meet the definition of an asset.

d. Opinion

The expenditure incurred by the company relating to ROC fees for authorized capital and incidental professional / legal fees paid at the time of formation cannot be considered as share issue expenses as it does not meet the definition of an asset and should be treated as expense and charged off in the statement of profit and loss as and when incurred as per the requirements of paragraph 56 of AS 26.

1.2 Amendments to Ind AS

Ministry of Corporate Affairs (MCA) has amended the following Ind AS which are effective for accounting periods beginning on or after 1st April 2018 and has also laid down the transitional provisions for its prospective and retrospective applicability.

Ind AS	**Brief about the amendments**
Ind AS 40- Investment Property	The amendment lays down the principle regarding when a company should transfer asset to, or from, investment property.
Ind AS 21- The Effects of Changes in Foreign Exchange Rates	Clarity is given in regard to exchange rate to be applied for translation of foreign currency advance paid or received in regard to non-monetary transactions i.e. non-refundable amounts.
Ind AS 12- Income Taxes	Amendments explains about the principles to be applied for offset of deductible temporary differences against taxable income and no deferred tax asset is recognised if the reversal of the deductible temporary difference will not lead to tax deductions.
Ind AS 28- Investment in Associates in Other Entities	It is clarified that a venture capital organisation, or a mutual fund, unit trust and similar entities may elect, at initial recognition, to measure investments in an associate or joint venture at fair value through profit or loss separately for each associate or joint venture.
Ind AS 112, Disclosure of interest in other entities	It is clarified that disclosure requirements also applies to interest classified as discontinued operations or assets held for sale.

1.3 New Ind AS notified

MCA has notified Ind AS 115- Revenue from Contracts with Customers which is effective for accounting periods beginning on or after 1st April 2018. With the introduction of Ind AS 115, existing Ind AS 11- Construction Contracts, Ind AS 18- Revenue and revised guidance note on Accounting of Real Estate Transactions for Ind AS entities issued by the ICAI are replaced.

1.4 ITFG Bulletin 15

Summary of clarification given under ITFG bulletin 15 is as under:

Sr. no.	Clarifications
1.	**Discounting rate to be used for FCCB:** To determine the present value of financial liability at the initial recognition in case of Foreign Currency Convertible Bonds (FCCB), the rate of interest at which the liability portion of the FCCB is to be discounted should be the market rate of interest prevailing at the time of issue of FCCB. This discount rate should be comparable to the instrument for aspects, such as, currency, time period, credit status and cash flows, but without conversion option.
2.	**Accounting treatment for preference shares and dividend:** In case of non-cumulative compulsory redeemable preference shares which are issued to non-related party and dividends are payable at the discretion of the company, accounting treatment for preference shares and dividend which are not yet declared by the company is as under: Accounting of preference shares: The instrument is compound financial instrument as per the requirements of Ind AS 32- Financial Instrument, Presentation since the discretion for payment of dividend is with the issuer. Accordingly, on initial recognition, the fair value of the instrument will be bifurcated into liability and equity component. The fair value of the liability component is determined as the present value of the eventual redemption amount discounted at the market rate of return. The equity component is the residual amount. The unwinding of the discount on this component is recognised in profit or loss and classified as interest expense. Accounting of dividend: Any discretionary dividends will be recognised when they are actually declared and paid and will relate to the equity component and accordingly, are recognised as a distribution of profit or loss.

<table>
<tr><th>Sr. no.</th><th>Clarifications</th></tr>
<tr><td>3.</td><td>Incentive receivable in the form of Sales tax refund- Whether it is financial instrument under Ind AS 109?

A financial instrument arises as a result of contractual obligation between the parties. Under the sales tax refund schemes, there may not be a one to one agreement between the entity and the government as to the rights and obligations but there is an understanding between the government and the entity that on complying with the stipulated conditions attached to the scheme, the entity will be granted benefits of the scheme.

If the entity has complied with the conditions attached to the scheme then it rightfully becomes entitled to such incentives. Accordingly, such incentive receivable will fall under the definition of financial instruments and will be accounted for as a financial asset per Ind AS 109.</td></tr>
<tr><td>4.</td><td>Applicability of Ind AS

In case of the company which has net worth less than Rs. 250 crores as on 31st March 2017, the status of applicability of Ind AS under various scenarios will be as under :
<table>
<tr><th>Scenario</th><th>Ind AS applicable- Yes/no / Remarks</th></tr>
<tr><td>Company was in the process of listing as at 1st April 2017 and the company ultimately gets listed as at 31st March 2018</td><td>Yes. Applicable for FY 2017-18</td></tr>
<tr><td>The company is listed at the beginning of the year 1st April 2017 and during the year it gets de-listed</td><td>Yes. Applicable for FY 2017-18</td></tr>
<tr><td>The process of listing began during the year, for e.g. in the month of May 2017 and the company ultimately gets listed as at the end of the year i.e. March 2018.

Whether Ind AS is applicable for the quarter ended 31st December 2017 if company is listed in November 2017.

Will there be any difference if the company gets listed in April, 2018. i.e. it was in process of listing as at the year ended 31st March 2018.</td><td>Yes. Applicable for FY 2017-18.

Yes

Yes Applicable for FY 2017-18.</td></tr>
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<tr><th>Sr. no.</th><th>Clarifications</th></tr>
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<tr><td>The company issued listed debentures in the month of May 2017. However, in the month of January 2018, the debentures got de-listed.</td><td>No</td></tr>
<tr><td>Company was covered under NBFC roadmap for implementation of Ind AS w.e.f. 1st April 2018. Company had applied to SEBI for termination of membership of the exchange in July 2016 which was approved in August 2017. Company's net worth is Rs. 500 crores and also have debt listed securities. Whether the company should have prepared Ind AS financial statements as a Phase 1 non-NBFC corporate entity as of 31 March 2017 given it had applied for termination of membership with the exchange in the month of July 2016?</td><td>Yes, applicable from July 2016 assuming that NBFC activities are discontinued. This is applicable considering the net-worth criteria.</td></tr>
</table>
</td></tr>
<tr><td>5.</td><td>Retrospective application of accounting for business combinations of entities or business under common control

In case where the entity on transition to Ind AS has not opted for exemption under Ind AS 101 (i.e. opted to restate the past business combinations), it has to also comply with preparation of consolidated financial statements from that date i.e. date from which past business combination are restated.</td></tr>
<tr><td>6.</td><td>Discounting of interest free refundable security deposits paid by the entity

Interest free refundable security deposits (such as rent deposits paid to lessor) given by an entity is a financial instrument and should be classified as a financial asset in accordance with Ind AS 109.

Where the effect of time value of money is material, refundable security deposits should be discounted and should be shown at their present value at the time of its initial recognition. Rate at which these should be discounted then entity needs to evaluate based on its own facts and circumstances taking into account the guidance given in Ind AS 109.

In case of an interest free rent deposit paid to a lessor in respect of a non-cancellable operating lease arrangement, the difference between transaction price and fair value may be deferred as prepaid rent to be recognised as an expense over the underlying lease term in accordance with Ind AS 17.</td></tr>
</table>

Sr. no.	Clarifications
	The deposits which are contractually repayable on demand will be recognised at the transaction price on initial recognition similar to the initial recognition of demand deposit liabilities given under paragraph 47 of Ind AS 113.
7.	**Lease premium collected at the time lease deed – Recognition of lease income** In the give scenario, customer was allotted land for 99 years of lease. The customer was required to pay (i) a non-refundable lease premium at the time of execution of lease deed (which is the market of value of land) and (ii) nominal amount of annual lease rental payable over the period of 99 years. It is clarified that revenue arising from lease agreements would be in accounted with Ind AS 17, Lease and in the above scenario a lease of land for 99 years is an indication of finance lease. ITFG has referred to previous bulletin no. 7 (issue no. 5) which explains the broad principles to be assessed while classifying a lease as on operating or finance lease.
8.	**Accounting for outstanding retired partner's capital balances by a partnership firm** In the given scenario, partnership firm was considered as subsidiary and there accounts were required to be consolidated as per Ind AS. The firm had amounts outstanding towards retired partner's capital, which were repayable on demand. It is a financial liability as per Ind AS 32 and hence would initially be recognised at fair value. Further, as per para 47 of Ind AS 113, fair value of financial liability payable on demand is not less than the amount payable on demand and will not be discounted on initial recognition and on subsequent measurement.
9.	**Ind AS applicability to entities in a group** In the given scenario, Ind AS is applicable to listed subsidiary (entity B). The group structure of entity B comprises of unlisted holding company (entity A), unlisted fellow subsidiary (entity C) and unlisted entity D holding 25% stake in entity B. Net-worth is less than Rs. 250 crore in all these entities. Considering these facts and information, the applicability of Ind AS to these entities is as given below:

Sr. no.	Clarifications		
		Entity / Relation	**Ind AS applicable [Yes / No / Remarks]**
		A (holding company)	Yes
		C (fellow subsidiary)	No. However Ind AS financials of C will be required for consolidated accounts of A
		D (shareholder holding 25% stake in B)	No. However entity B has to prepare financial statements as per previous GAAP for consolidated accounts of entity D.

2 Company Law

2.1 Extension, relaxations, notification and amendments

- Section 132(3) and (11) of the Companies Act 2013 related to constitution of National Financial Reporting Authority are effective from 21st March 2018

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