ACCOUNTING AND COMPANY LAW

N. A. SHAH BULLETIN

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EXECUTIVE SUMMARY:

- **Accounting**

    - Expert Advisory Opinion

        - The Institute of Chartered Accountants of India (ICAI) has issued an expert advisory opinion on presentation of interest income earned on surpluses of milestone receipts in relation to Construction Contracts. As per the opinion, interest income earned by companies other than finance company should be classified under the head 'Other income' and not under 'Other operating revenue' in accordance with Schedule III to the Companies Act, 2013 ('the Act').

    - Accounting Standard Board, ICAI has issued the following exposure drafts:

        a. Appendix C, Uncertainty over Income Tax Treatments to Ind AS 12, Income Taxes
        b. Ind AS 16, Property Plant and Equipment
        c. Amendments to Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance.

    - Ind AS Transition Facilitation Group (ITFG) of Ind AS Implementation Committee has issued Bulletin 13 which provides clarifications on various issues related to applicability and/or implementation of Ind AS.

- **Company Law**

    - Ministry of Corporate Affairs (MCA) has
        - notified various sections of the Companies (Amendment) Act 2017,
        - issued notification for easing the compliances at the time of incorporation of company,
        - made procedural changes in allotment of DIN,
        - revised the filing fees, registration fees, etc.

- **Auditing**

    - ICAI has issued revised standard on auditing SA 720 (R), 'The Auditor's Responsibilities Relating to Other Information' and is applicable for periods beginning on or after 1st April 2018.

    - The Auditing and Assurance Standards Board (AASB) of ICAI has issued revised formats of the statutory auditor's report for urban cooperative banks (UCBs).

1 Accounting - Expert Advisory Opinion

Accounting treatment of temporary income in relation to Construction Contract.

a. Facts of the case

- A public sector shipyard ('Company') under the Ministry of Defense is in the business of construction of warships. Company receives contract of fixed price with certain variable components such as foreign exchange variation, cost of spares, etc. Company recognizes revenue on percentage completion method as per Accounting Standard (AS) 7, 'Construction Contracts'.

- Receipt for fixed price part is on milestone basis which spreads over 10 – 12 milestones starting with initial receipt of 10% on signing of the contract. Since the gestation period of contracts is longer, temporary surplus funds are initially deployed in short-term fixed deposits. In the later part of execution of the contract, cost incurred exceeds the receipts. Interest earned on temporary surplus investment compensates to a certain extent for such deficit in cash flow.

- Contract price is disclosed as operating revenue and interest earned from surplus of milestone receipts is disclosed as other Income.

- As per the Company's view, interest earned should be disclosed under other operating revenue based on the reasons given below:

  - Operating cycle ranges from 3 to 4 years. Milestone receipts are directly linked to the physical progress of the project and are not released if milestones are not achieved. Thus, milestone receipts and interest arises from operations.
  - If milestone receipts were not agreed, Company will have to arrange funds to meet its working capital requirements and cost of funds would be factored in contract price. Hence, interest earned should be treated as part of core business activities.
  - Notional interest income on temporary surpluses of milestone receipts is considered by the customer as a negotiating point during the price negotiation of the contracts.

b. Query

Whether interest earned on deposits made out of temporary surpluses of milestone receipts can be considered as 'Other operating revenue'.

c. Points considered by the Committee

- The basic issue raised by the querist relates to presentation of interest earned during execution of contract under the head 'Other income' or 'Other operating revenue'. The opinion is based on this perspective only.

- The Committee notes that as per Guidance Note on Schedule III ('GN') to the Act, non-finance companies are required to disclose revenue from (a) sale of products, (b) sale of services and (c) other operating revenues separately.

- As per the GN, the term other operating revenue is not defined. This will include revenue arising from a Company's operating activities, i.e., either its principal or ancillary revenue-generating activities, but which is not revenue arising from the sale of products or rendering of services.

- As per Note 4 to General Instructions for the preparation of Statement of Profit and Loss, 'Other Income' shall be classified as:
  (a) Interest Income (in case of a company other than a finance company)
  (b) Dividend Income;
  (c) Net gain/loss on sale of investments;
  (d) Other non-operating income (net of expenses directly attributable to such income)

- From the above, the Committee notes that all types of interest income in case of non-finance companies are required to be disclosed under 'Other income'.

d. Opinion

Considering the Company's business and on the basis of the above mentioned points, the Committee is of the view that interest income from temporary investments of milestone receipts cannot be classified as 'Other operating revenue' and same should be classified as 'Other income'.

2 Company Law

2.1 Sections of Companies (Amendment) Act, 2017 notified

a. Section 1 (power of Central Government to notify applicability date for different provisions) and Section 4 (reservation of name) has been notified w.e.f. 26th January, 2018.

b. The following sections have been notified w.e.f 9th February, 2018:

Sr. No.	Sections of Companies (Amendment) Act, 2017	Amended Section of Companies Act, 2013	Title
1	Section 2 (except clause(i) and clause(xiii))	Section 2 (except clause 6 and clause 87)	Definitions w.r.t. Associate Company & Subsidiary Company has not been notified
2	Section 3	Insertion of Section 3A	Member severally liable in certain cases
3	Section 7	Section 21	Authentication of documents, proceedings & contracts
4	Section 9	Section 35	Civil liability for mis-statements in prospectus
5	Section 11	Section 47	Voting Rights
6	Section 12	Section 53	Prohibition on issue of shares at discount
7	Section 14	Section 62	Further issue of share capital
8	Section 17	Section 76A	Punishment for contravention of section 73 or section 76.
9	Section 27	Section 100	Calling of extraordinary general meeting
10	Section 28	Section 101	Notice of meeting
11	Section 29	Section 110	Postal Ballot
12	Section 32	Section 123	Declaration of dividend
13	Section 34	Section 130	Re-opening of accounts on court's or tribunal's orders
14	Section 35	Section 132	Constitution of National Financial reporting Authority (NFRA)
15	Section 38	Section 136	Right of member to copies of audited financial statement
16	Section 41	Section 140	Removal, resignation of auditor and giving of special notice
17	Section 42	Section 141	Eligibility, qualifications and disqualifications of auditors
18	Section 43	Section 143	Powers and duties of auditors and auditing standards
19	Section 44	Section 147	Punishment for contravention
20	Section 45	Section 148	Central Government to specify audit of items of cost in respect of certain Companies
21	Section 47	Section 152	Appointment of directors
22	Section 48	Section 153	Application for allotment of Director Identification Number ('DIN')
23	Section 50	Section 160	Right of persons other than retiring directors to stand for directorship
24	Section 51	Section 161	Appointment of additional director, alternate director and nominee director
25	Section 53	Section 165	Number of directorships
26	Section 59	Section 180	Restrictions on powers of Board
27	Section 60	Section 184	Disclosure of interest by director
28	Section 63	Section 188	Related Party Transactions

Sr. No.	Sections of Companies (Amendment) Act, 2017	Amended Section of Companies Act, 2013	Title
29	Section 64	Section 194	Prohibition on forward dealings in securities of Company by director or key managerial personnel (Omitted)
30	Section 65	Section 195	Prohibition on insider trading of securities (Omitted)
31	Section 72	Section 223	Inspector's report
32	Section 73	Section 236	Purchase of minority shareholding
33	Section 74	Section 247	Valuation by registered valuers
34	Section 77	Section 379	Application of Act to Foreign Companies
35	Section 78	Section 384	Debentures, annual return, registration of charges, books of account and their inspection
36	Section 79	Section 391	Application of section 34 to 36 and Chapter XX
37	Section 82	Section 409	Qualification of President and Members of Tribunal
38	Section 84	Section 411	Qualification of Chairperson and Members of Appellate Tribunal
39	Section 85	Section 412	Selection of Members of Tribunal and Appellate Tribunal
40	Section 90	Section 441	Compounding of certain offences
41	Section 91	Insertion of Section 446A & 446B	Factors for determining level of punishment & Lesser penalties for One Person Companies or Small Companies
42	Section 92	Section 447	Punishment for fraud
43	Section 93	Section 458	Delegation by Central Government of its powers and functions

2.2 Compliances at the time of incorporation of Companies made easier

In connection with the incorporation of Companies, following changes are made by the Companies (Incorporation) Amendment Rules, 2018 which are applicable from 26th January, 2018:

- Application of reservation of name is to be made through web service by using Reserve Unique Name (RUN) instead of Form INC-1.
- Form INC-7 has been omitted.
- Where there are more than 7 subscribers or where any of the subscriber is signing at a place outside India, filing of Form INC-33 and Form INC-34 is not required if MOA and AOA is filed with Form INC-32.

- Filing fees of Form INC-32 is waived if Companies incorporated w.e.f 26th January, 2018
  - have nominal capital of less than or equal to Rs. 10 lakhs or
  - have number of members as stated in the AOA does not exceed 20.
- Form INC-1, INC -3, INC-12, INC-22, INC-24 and INC-32 has been changed.

2.3 Procedural changes in allotment of DIN

Following changes are made by the Companies (Appointment and Qualification of Directors) Amendment Rules, 2018 which are applicable from 26th January, 2018:

- Form DIR-3 and Form DIR-12 are changed.
- Other amendments are as under:

Sr. No.	Erstwhile provision	Change(s)	Our Comments / View
1	Individuals who were to be appointed as director (proposed director) were required to file Form DIR-3 for application of DIN.	In case of new companies, details of maximum 3 proposed directors not having approved DIN can be mentioned in Form INC-32 and DIN would be allotted through Form INC-32.	Now, the DIN allotment will be in two ways: for existing companies, through Form DIR-3 and for new companies, through Form INC- 32. This will facilitate ease of doing business.
2	-	Proposed director is also required to submit the board resolution proposing his appointment as director.	-
3	Practising Chartered Accountants / Cost Accountants / Company secretaries were allowed to verify the Form DIR-3.	a. This option is now removed. b. Now, CEO or CFO is allowed to verify the Form DIR-3.	-

3 Indian Accounting Standards (Ind AS)

3.1 Exposure Drafts

3.1.1 Exposure draft on Appendix C to Ind AS 12, Income Taxes

ICAI has issued exposure draft on proposed Appendix C, Uncertainty over Income Tax Treatments to Ind AS 12, Income Taxes which were open for comments upto 19th February, 2018.

3.1.2 Exposure draft on Ind AS 16, Property, Plant and Equipment

ICAI has issued exposure draft on proposed Property, Plant and Equipment which were open for comments upto 24th February, 2018.

3.1.3 Exposure draft on Amendments to Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance

ICAI has issued exposure draft on proposed Accounting for Government Grants and Disclosure of Government Assistance which were open for comments upto 24th January, 2018.

3.2 ITFG Bulletin 13

Summary of clarification given under ITFG bulletin 13 is as under:

Sr. no.	Clarifications
1.	Dividend Distribution Tax (DDT) paid on distribution of dividend to preference shareholders (that are classified as liability as per Ind AS 32, Financial Instruments: Presentation), can be capitalised as borrowing costs along with the qualifying asset in accordance with the principles of Ind AS 23, Borrowing Costs.
2.	Where director has given personal guarantee for the loan taken by the Company in which he is a director, Company is not required to account for the financial guarantee received from its director. Ind AS 109 provides principles for accounting by the issuer of the guarantee. However, it does not specifically address the accounting for financial guarantees by the beneficiary. Company needs to make disclosures of such financial guarantee in accordance with Ind AS 24, Related Party Disclosures.
3.	Paragraph 34 of Ind AS 108, Operating Segments require entities to disclose information about its major customers i.e. those contributing 10% or more of its total amount of revenue. Such disclosure is required even in case where the Company operates into only one segment.

4.	Roadmap for the applicability of Ind AS as applicable to NBFCs will also apply to the Company which is carrying on the activity of NBFC but not registered with RBI.
5.	Company cannot disclose operating profit on the face of Statement of Profit and Loss as it is not in accordance with Ind AS based Schedule III of the Companies Act 2013 (Ind AS Schedule III). Ind AS Schedule III and Ind AS requires classification of expense by nature and classification of expenses by function is not permitted. However, the entity may provide such additional information in the financial statements.
6.	If there has been a renegotiation of terms of (defaulted) borrowings subsequent to the year end, but before the date of approval of financial statements, then such modification gain / loss is to be recognised in the next year, when the terms of (defaulted) borrowings have been renegotiated in accordance with Ind AS 109.
7.	Parent had 70% stake in subsidiary. The other investor invested additional funds in the subsidiary reducing the parent's stake to 60%. However, there was no loss of control by the Parent. Accounting treatment in respect of this partial deemed disposal in the Separate Financial Statements (SFS) of the Parent assuming that investment in subsidiary is measured at cost and accounting treatment in the Consolidated Financial Statements (CFS) is given as under: **I. <u>Treatment in SFS of the Parent entity:</u>** a. There will be no impact in the SFS of parent entity and investment will continue to be recognised at its carrying amount. b. However, the fact that its shareholding has been reduced from 70% to 60% should be disclosed appropriately in the financial statements. **II. <u>Treatment in CFS of the Parent entity:</u>** a. Since the parent does not lose control, there will be no impact on goodwill or Statement of Profit and Loss. b. The entity shall recognise any difference between the amount by which the Non-controlling interest (NCI) are adjusted and the fair value of the consideration paid or received directly in equity and attribute it to the owners of the parent. c. NCI are recorded at fair value only at the date of the business combination. Subsequent purchases or sales of ownership interests when control is maintained are recorded at the NCI's proportionate share of the net assets.

	d. As per paragraph 18 of Ind AS 112, Disclosure of Interests in Other Entities, an entity is required to present a schedule that shows the effects on the equity attributable to owners of the parent, of any changes in its ownership interest in a subsidiary that do not result in a loss of control.
8.	Foreign currency risk disclosure as per Ind AS 107 will apply even if Company has availed the option available under paragraph D13AA of Ind AS 101, i.e., to continue the policy adopted for capitalising the exchange difference arising from translation of long-term foreign currency monetary items recognised in the previous GAAP financial statements.
9.	The accounting treatment of dividend distribution tax (DDT) in the Consolidated financial statements (CFS) in case of partly-owned subsidiary in the following scenarios: **Scenario 1:** H Limited (H Co.) holds 12,000 equity shares in S Limited (S Co.) with 60% holding. Accordingly, S Co. is a partly-owned subsidiary of H Co. During the year 2017, S Co. paid a dividend of Rs. 10 per share and DDT @ 20% amounting to Rs. 40,000. Should the share of H Co. in DDT paid by S Co. amounting to Rs. 24,000 be charged as expense in the consolidated profit and loss of H Co.?
	Reply: a. In the CFS of H Co., dividend income earned by H Co. and dividend recorded by S Co. in its equity will both get eliminated as a result of consolidation adjustments. b. Dividend paid by S Co. to NCI will be recorded in Statement of Changes in Equity as reduction of NCI balance (as shares are classified as equity as per Ind AS 32). c. DDT of Rs. 24,000 (related to H Co's shareholding) paid outside the consolidated group to tax authorities shall be charged as tax expense in the Consolidated Statement of Profit and Loss. d. DDT of ₹ 16,000 (pertaining to NCI) will be recorded in the Statement of Changes in Equity along with dividend.
	Scenario 2(A): Extending the situation given in scenario 1, H Co. also pays dividend of Rs. 3 Lakhs and DDT @ 20%. As per the tax laws, DDT paid by S Co. is allowed to be set off against the DDT liability of H Co., resulting in H Co. paying Rs. 36,000 (Rs. 60,000 – Rs. 24,000) as DDT to tax authorities.
	Reply: a. If DDT paid by the subsidiary S Ltd. is allowed as a set off against the DDT liability of its parent H Ltd. (as per the tax laws), then the amount of such

	DDT should be recognised in the consolidated statement of changes in equity of parent H Ltd. In the given case, share of H Limited in DDT paid by S Limited is ₹ 24,000 and entire ₹ 24,000 was utilised by H Limited while paying dividend to its own shareholders. Accordingly, DDT of ₹ 76,000 (₹ 40,000 of DDT paid by S Ltd. (of which ₹ 16,000 is attributable to NCI) and ₹ 36,000 of DDT paid by H Ltd.) should be recognised in the consolidated statement of changes in equity of parent H Ltd. b. No amount will be charged to Consolidated Statement of Profit and Loss. c. The basis for such accounting is that due to Parent H Ltd.'s transaction of distributing dividend to its shareholders (a transaction recorded in Parent H Ltd.'s equity) and the related DDT set-off, this DDT paid by the subsidiary is effectively a tax on distribution of dividend to the shareholders of the Parent Company.
	Scenario 2(B): If in (A) above, H Co. pays dividend amounting to Rs. 100,000 with DDT @ 20%.
	Reply: Share of H Co. in DDT paid by S Co. is Rs. 24,000 out of which only Rs. 20,000 was utilised by H Co. while paying dividend. Therefore, balance Rs. 4,000 should be charged in the Consolidated Statement of Profit and Loss.
	Scenario 3: Will the answer be different for the treatment of DDT paid by associate in the CFS of investor, if as per tax laws the DDT paid by associate is not allowed to set-off against the DDT liability of the investor?
	Reply: If DDT paid by associate is not to allowed set off against the DDT liability of the investor, the investor's share of DDT would be accounted by the investor company by crediting its investment account in the associate and recording a corresponding debit adjustment towards its share of profit or loss of the associate.
10.	For the purpose of calculating fair value of financial liability in case of compulsorily convertible debentures (CCD) @ 14.50% p.a. which will be converted at the end of 10 years, it cannot be compared with the market rate of interest for unsecured loan of 14.50% p.a. The fair value of the liability shall be the present value of the contractually determined stream of future cash flows discounted at the rate of interest applied at that time by the market to instruments of comparable credit status and providing substantially the same cash flows, on the same terms, but without the conversion option.

4 Auditing

4.1 Revised formats for auditor's report for Urban Cooperative Banks (UCBs)

AASB has issued revised formats of the statutory auditor's report for UCBs. These formats have been developed in consultation with RBI and the same have also been accepted by the RBI.

4.2 Revised standard on auditing

ICAI has issued revised standard on auditing SA 720 (R), 'The Auditor's Responsibilities Relating to Other Information'. This SA is applicable for periods beginning on or after 1st April 2018. This SA is applicable for audits of all the listed entities and unlisted entities. The auditor is required to report on the other information in accordance with this SA. However, the reporting requirement of this SA is not applicable in case of unlisted & non-corporate entities. Auditor is required to document the procedures performed and final version of the other information on which he has performed the work.

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