PwC ReportingPerspectives

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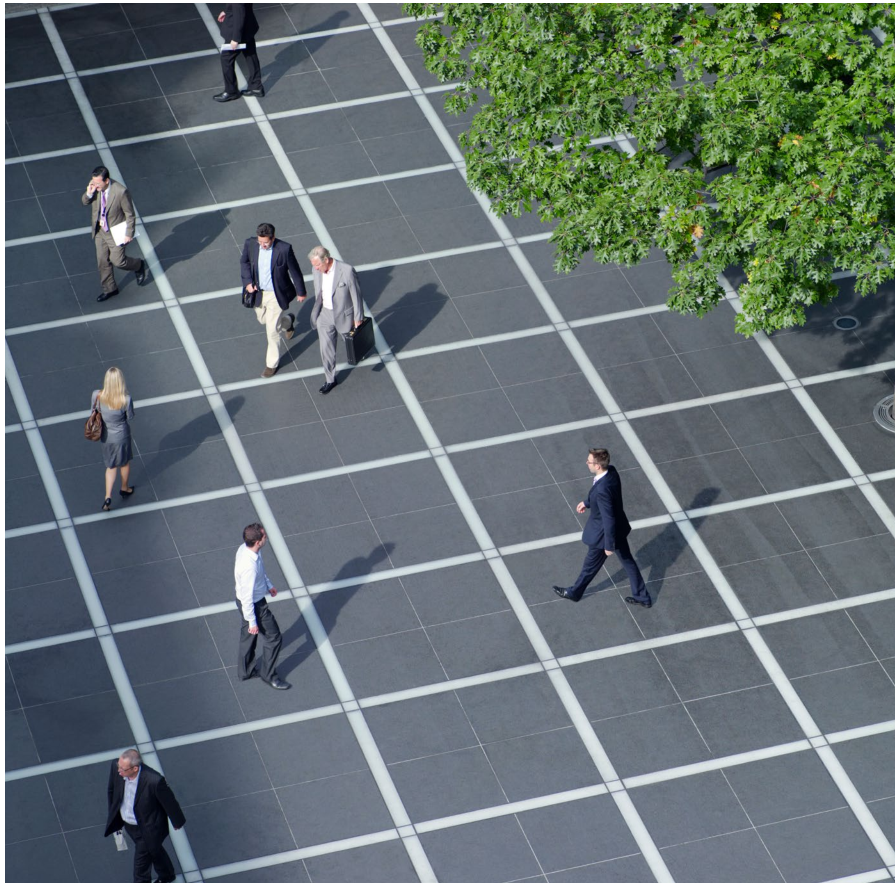


Editorial

We are pleased to bring you the 13th edition of our quarterly newsletter covering the latest developments in financial reporting as well as other regulatory updates.

Ind AS 23, 'Borrowing costs', is one of the shortest standards in Ind AS. However, practical implementation of this seemingly simple standard often raises questions for which the standard provides limited guidance. In this edition, we take a close look at some of the practical questions that arise on application of Ind AS 23.

On 22 December 2017, the US President Donald Trump signed tax reform legislation which includes a broad range of tax reform proposals affecting businesses involving US operations. We have provided an overview of the key provisions of the US tax reform and the IFRS accounting implications of such tax law changes.

This edition also covers the key recommendations of the report submitted by the committee on corporate governance formed by Securities and Exchange Board of India (SEBI), the amendments arising from the Financial Accounting Standards Board's (FASB's) revised guidance on the definition of a 'business' and International Accounting Standards Board's (IASB's) annual improvements to the IFRS 2015–2017 Cycle.

Finally, as always, we have summarised other Indian as well as global regulatory updates.

We hope you find this newsletter informative and of continued interest.

We welcome your feedback at pwc.update@in.pwc.com

Ind AS 23, 'Borrowings costs' – from theory to practice

At a glance:

Ind AS 23, 'Borrowing costs', is one of the shortest standards in Ind AS. However, practical implementation of this seemingly simple standard often raises questions for which the standard provides limited guidance. Challenges include specific versus general borrowings, when to start capitalisation, total borrowing costs eligible for capitalisation, and which foreign exchange differences should be considered as borrowing costs. In this edition, we take a close look at some of the practical questions that arise on application of Ind AS 23.

1 *Core principle and definitions*

The core principle of Ind AS 23 is simple: borrowing costs that are directly attributable to the acquisition or construction of a qualifying asset must be capitalised. All other borrowing costs should be expensed.

There are only two defined terms in Ind AS 23: 'borrowing costs' and 'qualifying asset'.

Borrowing costs are 'interest and other costs that an entity incurs in connection with the borrowing of funds'.

A qualifying asset is defined as 'an asset that necessarily takes a substantial period of time to get ready for its intended use or sale'. Examples of qualifying assets are manufacturing plants, real estate, and infrastructure assets such as bridges and railways.

Ind AS 23 is not mandatory for assets measured at fair value, such as biological assets. It also excludes from its scope inventories manufactured in large quantities on a repetitive basis. However, an entity can choose to capitalise borrowing costs on types of assets that are outside the scope of the standard.

We consider below certain application issues that we have observed in practice and specific questions related to various aspects of Ind AS 23.

2 *Qualifying assets*

One of the three conditions that must be met before commencing the capitalisation of borrowing costs is that an entity incurs expenditures for the qualifying asset. Assets that are ready for their intended use or sale when acquired are not qualifying assets, as the asset must require a substantial period of time to get ready for its use or sale. The standard does not define 'substantial' and a benchmark of 12 months is often used, but a shorter period might be justified as well.

We consider below some frequently asked questions about qualifying assets.

2.1 Is there a rule for determining the 'substantial period of time'?

Response: No. Ind AS 23 does not define 'substantial period of time'. Management exercises judgement when determining which assets are qualifying assets, taking into account, among other factors, the nature of the asset. An asset that normally takes more than a year to be ready for use will usually be a qualifying asset. Once management chooses the criteria and types of asset, it applies this consistently to those types of asset.

2.2 Can borrowing costs incurred to finance the production of inventories that have a long production period, like wine or cheese, be capitalised?

Response: Yes. Ind AS 23 does not require the capitalisation of borrowing costs for inventories that are manufactured in large quantities on a repetitive basis. Interest capitalisation is, however, permitted as long as the production cycle takes a 'substantial period of time', as with wine or cheese. To capitalise borrowing costs on those inventories is an accounting policy choice.

2.3 Can an intangible asset be a 'qualifying asset' under Ind AS 23?

Response: Yes. An intangible asset that takes a substantial period of time to get ready for its intended use or sale is a 'qualifying asset'. This would be the case for an internally generated intangible asset in the development phase when it takes a 'substantial period of time' to complete, such as software.

2.4 Is management intention taken into account when assessing whether an asset is a qualifying asset?

Response: Management should assess whether an asset, at the date of acquisition, is 'ready for its intended use or sale'. The asset might be a qualifying asset, depending on how management intends to use it. For example, when an acquired asset can only be used in combination with a larger group of fixed assets or was acquired specifically for the construction of one specific qualifying asset, the assessment of whether the acquired asset is a qualifying asset is made on a combined basis.

Illustrative example: *A telecom licence*

Facts: *A telecom company has acquired a 3G licence. The licence could be sold or licensed to a third party. However, management intends to use it to operate a wireless network. Development of the network starts when the licence is acquired.*

Question: *Should borrowing costs on the acquisition of the 3G licence be capitalised until the network is ready for its intended use?*

Response: *Yes. The licence has been exclusively acquired to operate the wireless network. The fact that the licence can be used or licensed to a third party is not relevant in this case. The acquisition of the licence is the first step in a wider investment project (developing the network). It is part of the network investment, which meets the definition of a qualifying asset under Ind AS 23.*

Illustrative example: *Acquisition of a permit and equipment*

Facts: *A real estate company has incurred expenses for the acquisition of a permit allowing the construction of a building. It has also acquired equipment that will be used for the construction of various buildings.*

Question: *Can borrowing costs on the acquisition of the permit and the equipment be capitalised until the construction of the building is complete?*

Solution: *Yes for the permit, which is specific to one building. It is the first step in a wider investment project. It is part of the construction cost of the building, which meets the definition of a qualifying asset.*

No for the equipment, which will be used for other construction projects. It is ready for its 'intended use' at the acquisition date. It does not meet the definition of a qualifying asset.

3 *Borrowing costs*

The standard has specific requirements for determining borrowing costs eligible for capitalisation for specific borrowings and general borrowings. Specific borrowings are funds borrowed specifically for the purpose of obtaining a qualifying asset. For specific borrowings, the actual costs incurred are capitalised. If the entity temporarily reinvests some funds, investment income earned should be deducted from the borrowing costs eligible for capitalisation.

All borrowings that are not specific represent general borrowings. Costs eligible for capitalisation are calculated by applying a capitalisation rate to the expenditures on qualifying assets. The capitalisation rate is the weighted average of the borrowing costs applicable to the borrowings of the entity that are outstanding during the period. The amount of borrowing costs eligible for capitalisation is always limited to the amount of actual borrowing costs incurred during the period.

3.1 Is dividend on preference shares capitalised as borrowing costs?

Response: The accounting treatment of dividends depends on the classification of preference shares. When preference shares are classified as a liability, dividends in substance represent interest costs and are included in borrowing costs. For preference shares classified as equity, dividends are not included in borrowing costs.

3.2 Is accretion of interest on decommissioning obligations and other types of provisions capitalised as borrowing costs?

Response: Accretion of interest on decommissioning obligations is excluded from borrowing costs. Paragraph 8 of Appendix A, 'Changes in Existing Decommissioning, Restoration and Similar Liabilities', of Ind AS 16, 'Property, plant and equipment', specifically states that capitalisation of accretion of interest on decommissioning obligations under Ind AS 23 is not allowed.

Accretion of interest on other types of provisions, although not specifically mentioned in Ind AS 23, is generally excluded from borrowing costs. Borrowing costs are defined as interest and other costs that an entity incurs in connection with the borrowing of funds. Accretion of interest on provisions created based on the requirements of Ind AS 37, 'Provisions, contingent liabilities and contingent assets', does not meet the definition of borrowing costs.

3.3 A subsidiary obtained an interest-free loan from its parent and used it for the construction of a qualifying asset. The difference between the fair value of the loan and the funds received has been treated as an addition to the subsidiary's equity. Is the accretion of interest capitalised as borrowing costs in the subsidiary's separate financial statements?

Response: Financial liability is initially recognised at fair value as per Ind AS 109, 'Financial instruments'—that is, the present value of the future cash to be paid is discounted using the prevailing market rate for a similar instrument with a similar credit rating. The financial liability is subsequently measured at amortised cost, with interest accrued using the effective interest rate method. The interest determined using the effective interest method is an element of the borrowing costs and is considered for determining the costs eligible for capitalisation.

Ind AS 23 para 6(a) considers interest expense calculated using the effective interest rate method as per Ind AS 109 as eligible borrowing costs.

Ind AS 109 defines the effective interest rate as the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset or to the amortised cost of a financial liability. The calculation includes all fees paid or received that are an integral part of the effective interest rate, transaction costs and all other premium or discounts.

3.4 Are the effects of a cash flow or fair value hedging relationship on interest for a specific project borrowing capitalised?

Response: Yes. Ind AS 23 does not address whether the effects of hedging should be capitalised. However, the purpose of an Ind AS 109 hedging relationship is to modify the borrowing costs of the entity related to a specific loan. We therefore believe that entities should capitalise interest on borrowings in an Ind AS 109 designated hedging relationship after taking into account the effects of hedge accounting. Ineffectiveness on such hedging relationships should continue to be recognised in profit or loss in accordance with Ind AS 109.

3.5 Is it appropriate to capitalise gains and losses on derivative instruments (e.g. interest rate swaps and foreign currency swaps) that have not been designated in a hedging relationship under Ind AS 109?

Response: No. Such instruments fall under the category 'fair value through profit or loss'. As they have not been linked to borrowing activities of the entity through an Ind AS 109 hedging relationship, the gains and losses on such derivatives are not considered a borrowing cost as defined under Ind AS 23.

3.6 An entity has investment income on general borrowings. Does management deduct investment income from the borrowing costs available for capitalisation?

Response: There is no specific guidance given in Ind AS 23 about general borrowings, unlike specific borrowings (for which the amount of borrowing costs eligible for capitalisation is determined after deducting any investment income). The funds invested 'temporarily' cannot be considered to be those from the general borrowings rather than from other sources (e.g. equity or cash generated from operating activities). It cannot therefore be demonstrated that the income is earned from the general borrowings.

3.7 The entity uses general borrowings to finance its qualifying assets. However, cash flows from the operating activities would be sufficient to finance the capital expenditures incurred during the period. Can it be concluded that the general borrowings are used to finance working capital and other transactions (e.g. merger and acquisition activity) but not to finance the qualifying assets, in which case no borrowing costs would be capitalised?

Response: No. It is presumed that any general borrowings in the first instance are used to finance the qualifying assets (after any funds specific to a qualifying asset). This is the case even where the cash flows from operating activities are sufficient to finance the capital expenditures. The capitalisation rate is applied to the full carrying amount of the qualifying asset. Apportioning of general borrowings between acquisition/construction of qualifying assets and other expenditures (e.g. on the basis of cash flows statement) is not supported by the guidance in Ind AS 23.

The amount of borrowing costs eligible for capitalisation is calculated as follows:

The amount of borrowing costs eligible for capitalisation is the actual borrowing costs incurred on a specific borrowing during the period, less any investment income on the temporary investment of those borrowings. [Ind AS 23, para 12].

The amount of borrowing costs eligible for capitalisation on general borrowings is determined by applying a capitalisation rate to the expenditures on qualifying assets. The capitalisation rate is the weighted average of the borrowing costs applicable to the borrowings of the entity that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. [Ind AS 23, para 14].

3.8 Are specific borrowings transferred to the general borrowings pool once the respective qualifying asset is completed?

Response: Yes. If specific borrowings were not repaid once the relevant qualifying asset was completed, they become general borrowings as long as they are outstanding.

The borrowing costs that are directly attributable to obtaining qualifying assets are those borrowing costs that would have been avoided if the expenditure on the qualifying asset had not been made. If cash was not spent on other qualifying assets, it could be directed to repay this specific loan. Thus, borrowing costs could be avoided (i.e. they are directly attributable to other qualifying assets).

The International Accounting Standards Board (IASB) has issued 'Annual Improvements to IFRS Standards 2015 – 2017 Cycle' in December 2017 to amend IAS 23 to clarify that if a specific borrowing remains outstanding after the related qualifying asset is ready for its intended use or sale, it becomes part of general borrowings.

3.9 An entity has arranged a loan to acquire a subsidiary. Should borrowing costs incurred on this loan be excluded from general borrowing costs eligible for capitalisation?

Response: Although no specific guidance exists in Ind AS, in 2009, the IASB considered whether debt incurred specifically to acquire a non-qualifying asset could be excluded from general borrowings. The IASB noted that IAS 23 excludes only debt used to acquire qualifying assets from the determination of the capitalisation rate. Thus, all borrowings which are not specific borrowings should be taken into account when determining costs eligible for capitalisation.

4 *Borrowing costs in group financial statements*

A number of practical issues arise with respect to capitalisation of borrowing costs in the consolidated financial statements of a group. Are the borrowing costs that are eligible for capitalisation in consolidated financial statements simply a sum of borrowing costs capitalised by subsidiaries in their own financial statements? What is the amount of general borrowings capitalised in consolidated financial statements, if qualifying assets are in one group entity and general borrowings in another?

Financial statements of group entities have their own issues when the construction of a qualifying asset is financed by intra-group loans. This section focuses on issues arising both in the consolidated financial statements of a group and in those of individual entities in a group.

4.1 A subsidiary finances the construction of a qualifying asset with an inter-company loan. Are borrowing costs incurred on the inter-company loan capitalised in the financial statements of the subsidiary?

Response: Yes. Borrowing costs are capitalised by the subsidiary in its separate financial statements to the extent of the actual costs incurred by the subsidiary.

4.2 A subsidiary finances a qualifying asset through a capital increase, which is provided by the parent company. Can a notional amount of borrowing costs be capitalised in the separate financial statements of the subsidiary?

Response: No, because the subsidiary has not incurred any borrowing costs. The standard does not permit capitalisation of actual or imputed cost of equity.

4.3 Assume the same fact pattern as in 4.1 and 4.2 above. However, the parent company finances the capital increase with a bank loan. How is this accounted for in the financial statements of the parent company?

Response: In its separate financial statements, the parent recognises only the investment in the subsidiary. This is not a qualifying asset, so the borrowing costs cannot be capitalised.

In the consolidated financial statements of the parent, capitalisation of borrowing costs is required. However, the amount of the borrowing costs incurred by the subsidiary in the case of inter-company loans might be adjusted to reflect how the qualifying asset was financed from the perspective of the group as a whole:

i. If the group uses general external borrowings, the borrowing costs capitalised by the subsidiary are adjusted if the capitalisation rate at the group level is different from the rate used by the subsidiary.

ii. If the group uses specific external borrowings, the borrowing costs are adjusted if the borrowing costs on the external borrowings vary from the amount of borrowing costs capitalised by a subsidiary.

Borrowing costs calculated and capitalised in accordance with Ind AS 23 cannot exceed the amount of borrowing costs incurred by the group.

4.4 How are borrowing costs determined if qualifying assets are in one group entity and general borrowings in another?

Response: Consolidated financial statements are prepared as if they were the financial statements of a single entity. Therefore, the following guidelines are useful:

i. The intra-group interest is eliminated in consolidated financial statements.

ii. All borrowings of a parent and subsidiaries would normally be included in one pool, unless there are significant restrictions on transfer of funds among entities in the group (e.g. currency regulations or other restrictions imposed by the government).

5 *Foreign exchange differences*

Ind AS 23 requires capitalisation of foreign exchange differences relating to borrowings to the extent that they are regarded as an adjustment to interest costs. Para 6A of Ind AS 23 states that exchange difference required to be treated as borrowing costs shall be computed as below:

i. the adjustment should be of an amount which is equivalent to the extent to which the exchange loss does not exceed the difference between the costs of borrowing in functional currency when compared to the cost of borrowing in a foreign currency.

ii. where there is an unrealised exchange loss which is treated as an adjustment to interest and subsequently there is a realised or unrealised gain in respect of the settlement or translation of the same borrowing, the gain to the extent of the loss previously recognised as an adjustment should also be recognised as an adjustment to interest.

Let's look at how the computation of para 6A of Ind AS 23 works out in practice:

Illustration:

XYZ Limited has taken a loan of 10,000 USD on 1 April 20x1 for a special capital project at an interest rate of 5% p.a., payable annually. XYZ is an Indian company and has INR as its functional currency. On 1 April 20x1, the exchange rate between the currencies was 45 INR per USD. The exchange rate as at 31 March 20x2 is 48 INR per USD. The corresponding amount could have been borrowed by XYZ Ltd. in local currency, that is, INR at an interest rate of 11%. The average exchange rate for the year ended 31 March x2 is 48 INR per USD.

The following computation would be made to determine the amount of borrowing costs for the purposes of paragraph 6A of Ind AS 23:

i. Interest for the period = 10,000 USD x 5% x 48 = 24,000 INR

ii. Increase in the liability towards the principal amount = 10,000 USD x (48 - 45) = 30,000 INR

iii. Interest that would have resulted if the loan was taken in INR = 10,000 USD x 45 x 11% = 49,500 INR

iv. Difference between interest on local currency borrowing and foreign currency borrowing =49,500 INR - 24,000 INR = 25,500 INR

Therefore, out of the 30,000 INR increase in the liability towards the principal amount, only 25,500 INR will be considered as the borrowing cost. Thus, the total borrowing cost would be 49,500 INR, which is the aggregate of the interest of 24,000 INR on foreign currency borrowings and the exchange difference to the extent of the difference between the notional interest on local currency borrowing and actual interest on the foreign currency borrowing of 25,500 INR.

Accordingly, 49,500 INR would be considered as the borrowing cost to be accounted for as per Ind AS 23 and the remaining 4,500 INR would be considered as the exchange difference to be accounted for as per Ind AS 21, 'The effects of changes in foreign exchange rates'.

6 *Interaction between Ind AS 23 and Ind AS 11*

An entity might be constructing an asset for a customer under a construction contract to which Ind AS 11, 'Construction contracts', applies. Borrowing costs that are directly attributable to the construction of an asset which is accounted for under Ind AS 11 are treated as contract costs in accordance with Ind AS 23 and Ind AS 11, and included in the total cost of the asset.

The determination of the amount of borrowing costs to be capitalised in the financial statements of the contractor is based on the net position of the contract, after deducting customer payments received in advance in respect of the contract. No borrowing costs are capitalised when advances from customers exceed the contract costs incurred and the contract is in a net credit position during the whole construction period. The contractor has not incurred any borrowing costs, as the financing was provided by the client.

The net position in a contract might change over the construction period from a net debit to a net credit (or vice versa). Capitalisation is required for those periods when the contract is in a net debit position.

7 *Cessation of capitalisation*

A qualifying asset might be completed in parts, and each part can be used or operated separately. Capitalisation for one given phase or part ceases when this part is ready for its intended use or sale. Each subsequent phase or part will give rise to capitalisation of borrowing costs over its own construction period.

Illustrative example: Assets completed in phases

A retail store might be constructed in three phases: The first phase is the construction of the car park; the second phase is the construction of the core building; and the final phase is the construction and installation of internal fixtures and fittings. On completion of the first phase, the car park is made available to a nearby theatre to use as overflow parking. Capitalisation of borrowing costs in respect of phase one should cease when the car park is brought into use, despite the fact that phases two and three are incomplete. Phase one is being used for its intended use, which is the provision of parking facilities.

Capitalisation of borrowing costs associated with each part should cease when each part is capable of being used, even if it has not yet been put into use. However, this does not apply to a part of an asset that is not capable of being put into use without the completion of another part. For example, if the retail store is constructed as follows: The first phase is the construction of the core building and the main car park closest to the store; the second phase is the construction of the internal fixtures and fittings; and the final phase is the completion of the overflow car park. The first phase (that is, the basic building and initial car park) is not capable of being used as a store until the internal store fixtures and fittings are complete and, therefore, capitalisation of borrowing costs in respect of phases one and two should cease when both phases are complete, but before phase three is complete.

Key takeaways

As you will note from above, application of the requirements of Ind AS 23 can be challenging. We have attempted to provide guidance on how to apply the standard, not to create a subset of additional rules. Entities should consider the requirements of Ind AS 23 to their specific facts and circumstances, apply professional judgement and consult with their advisors as appropriate.

The Committee on Corporate Governance (the 'Committee') was formed on 2 June 2017 with the aim of improving the standards of corporate governance of listed companies in India. The Committee was requested to make recommendations to the Securities Exchange Board of India (SEBI) on the following issues, in the context of equity listed companies:

1. Ensuring independence in spirit of independent directors (IDs) and their active participation in the functioning of the company;
2. Improving safeguards and disclosures pertaining to related party transactions;
3. Issues in accounting and auditing practices by listed companies;
4. Improving effectiveness of board evaluation practices;
5. Addressing issues faced by investors on voting and participation in general meetings;
6. Disclosure and transparency related issues, if any;
7. Any other matter, as the Committee deems fit pertaining to corporate governance in India.

The recommendations included by the Committee in its report on 5 October 2017 have been arranged in the following chapters:

1. *Composition and role of the board of directors*
2. *The institution of IDs*
3. *Board committees*
4. *Enhanced monitoring of group entities*
5. *Promoters/controlling shareholders and related party transactions*
6. *Disclosures and transparency*
7. *Accounting and audit-related issues*
8. *Investor participation in meetings of listed entities*
9. *Governance aspects of public sector enterprises*
10. *Leniency mechanism*
11. *Capacity building in SEBI for enhancing corporate governance in listed entities*

We discuss some of the key recommendations of the Committee below:

1 *Composition and role of the board of directors*

The basic principle underlying the governance of a corporate entity is that the superintendence, control and direction of its business and affairs lie with its board of directors, with the executive management being delegated powers for smooth and efficient operational functioning. The Committee observed that while aspects relating to the composition and role of the board of directors of listed entities have been subjected to gradual reform, a holistic reassessment is required to further strengthen the same.

Accordingly, the recommendations of the Committee seek to address aspects relating, inter alia, to the size of the board and its diversity, separation of the roles of chairperson and executive management, attendance of directors at board meetings, ongoing updating of knowledge of directors and disclosure of their skills / expertise.

a. **Minimum number of directors on a board:** Board to comprise of a minimum of 6 directors.

b. **Gender diversity on the board:** Board to have at least one woman as an ID.

c. **Attendance of directors:** If the director does not attend at least half the total number of board meetings over the relevant period (i.e. two consecutive financial years on a rolling basis, commencing from the financial year immediately succeeding the date of appointment) his her continuance on the board is to be subject to ratification by shareholders at the next annual general meeting (AGM).

d. **Disclosure of expertise/skills of directors:** The corporate governance section in the annual report to contain a chart setting out the list of core skills/expertise/competencies identified by the board as required, and the names of the directors who have such skills/expertise/competence.

e. **Approval for non-executive directors (NEDs) on attaining a certain Age:** No person who has attained the age of 75 years to be appointed as or continue directorship as an NED, unless a special resolution is passed to that effect. In such cases, the explanatory statement annexed to the notice for such motion to indicate the justification for appointing such person.

f. **Minimum number of board meetings:** Board to meet at least five times a year, and at least once a year specifically to discuss strategy, budgets, board evaluation, risk management, environment, sustainability and governance (ESG), and succession planning.

g. **Updating of knowledge of board members:** Formal updating programme, at least once a year, for the board on changes in applicable laws, regulations and compliance requirements.

h. **NED engagement with the management:** Formal interaction between NEDs and senior management at least once a year.

i. **Quorum for board meetings:** Quorum for board meeting to be the higher of one-third of its total strength or three directors, including at least one ID, and subject to the requirements of the Companies Act, 2013 (the 2013 Act), the participation of directors by video conferencing or by other audio visual means to be counted for the purposes of quorum.

j. **Separation of the roles of non-executive chairperson and managing director/CEO:** Where the public shareholding is 40% or more at the beginning of a financial year, the chairperson to be an NED on and from that financial year; this provision may be extended by SEBI to all entities after two years.

k. **Matrix reporting structure:** The corporate governance report to include a confirmation that the board has been responsible for the business and overall affairs and that the reporting structures, formal and informal, are consistent with those given in the report.

l. **Maximum number of directorships:** Person serving as whole time director/managing director can serve as ID in not more than 3 listed entities; other persons can hold office as director, including alternate director, in not more than 8 listed entities (of which IDs are not to exceed 7), and not more than 7 listed entities one year later.

m. **Disclosures on board evaluation:** Guidance in the nature of a circular to be issued by SEBI specifying that following disclosures should be made as part of the disclosures on board evaluation: observations of board evaluation carried out for the year, previous year's observations and action taken, and proposed actions based on current year observations.

2 *The institution of IDs*

The institution of IDs forms the backbone of the corporate governance framework worldwide and in India. IDs are expected to bring objectivity into the functioning of the board and improve its effectiveness. IDs are required to safeguard the interests of all stakeholders, particularly minority shareholders, balance the conflicting interest of the stakeholders and bring an objective view to the evaluation of the performance of the board and management.

Given the importance of this role, the Committee observed that the institution of IDs, must be continually supported and strengthened. In this regard, the Committee recommended that there needs to be greater focus on the areas of eligibility, monitoring, awareness of role and functions, domain knowledge, provision of resources to play an effective role, adequacy of compensation vis-à-vis their responsibilities, addressing the fear of disproportionate liability, etc.

a. **Minimum number of IDs:** At least half the board to comprise IDs for the top 500 listed entities determined on the basis of market capitalisation as at the end of the immediately preceding financial year; and for all listed entities, one year later.

b. **Eligibility criteria for IDs:**

- The definition of ID to be amended. The wording in italics to be incorporated in the definition of ID. An 'ID' means an NED, other than a nominee director of the listed entity:

  i. who, in the opinion of the board of directors, is a person of integrity and possesses relevant expertise and experience;

  ii. who is or was not a promoter of the listed entity or its holding, subsidiary or associate company *or member of the promoter group of the listed entity; ………. (viii) who is not a non-independent director of another company on the board of which any non-independent director of the listed entity is an independent director*

- Evaluation of IDs to be done by the entire board and to include the performance of the directors and fulfilment of independence criteria specified in these regulations and their independence from management.
- The corporate governance report to include a confirmation that, in the board's opinion, the IDs fulfil the conditions specified in these regulations and are independent of management.
- Every ID shall, at the first meeting of the board in which he participates as a director and thereafter at the first meeting of the board in every financial year or whenever there is any change in the circumstances which may affect his status as an ID, give adeclaration that he/she meets the criteria of independence and that he is not aware of any circumstance or situation, which exist or may be reasonably anticipated, that could impair or impact his ability to discharge his duties with objective independent judgements and without any external influence.
- The board to take on record the above declaration and confirmation after undertaking due assessment of veracity of the same.

c. **Minimum compensation to IDs:** Minimum compensation to an ID in the case of the top 500 listed entities by market capitalisation to be an aggregate of 5 lakhs p.a., whether through sitting fees or profit-linked commission, subject to approvals under the 2013 Act. This is not applicable in cases of inadequacy of profits as per section 197 of the 2013 Act. For the top 100 entities by market capitalisation, the minimum sitting fees for each board meeting, audit committee meeting and board committee (other than audit committee) meeting to be 50,000 INR, 40,000 INR and 20,000 INR, respectively. For the next 400 entities by market capitalisation, the minimum sitting fees for each board meeting, audit committee meeting and board committee (other than audit committee) meeting to be 25,000 INR, 20,000 INR and 10,000 INR, respectively.

d. **Disclosures on resignation of IDs:** The corporate governance report to include detailed reasons for the resignation of IDs before the expiry of tenure; the director to also confirm that there are no other material reasons other than those provided, the disclosure of which shall also be made by the listed entity.

e. **Directors’ and officers’ insurance for IDs:** The Top 500 listed entities by market capitalisation calculated as on 31 March of the preceding financial year to undertake directors’ and officers’ insurance for all their IDs of such quantum and for such risks as determined by the board. This may further be extended to all listed entities.

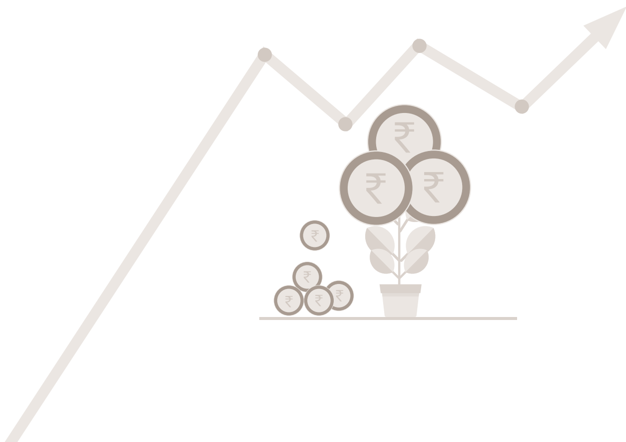
f. **Induction and training of IDs:** The formal induction process to include organisation structure and operations; formal training once every 5 years on their roles and responsibilities, with particular emphasis on governance aspects. IDs to certify compliance with the same to the listed entities every year. Such compliance to be ensured within 2 years of notification.

g. **Alternate directors for IDs:** Appointment of an alternate director for IDs is not to be permitted.

h. **Lead ID in companies with non-independent chairperson:** Entity to designate an ID as lead ID if it has a non-independent chairperson. Apart from membership of the nomination and remuneration committee, the lead ID to fulfil the role such as leading exclusive meetings of the ID and providing feedback to the chairperson/board of directors after such meetings, serving as a liaison between the chairperson and IDs, presiding over board meetings at which the chairperson and vice chairperson, if any, is not present, including executive sessions of IDs, having authority to call by significant shareholders, ensuring that he/she is available for consultation and direct communication.

i. **Exclusive meeting of IDs:** No amendments proposed.

j. **Casual vacancy of office of ID:** Appointment to fill a casual vacancy in the office of the ID to be subject to approval by the shareholders at the next general meeting and such director shall cease to hold office: a) if appointment is not approved at the said meeting; b) on the last date on which the meeting ought to have been held; whichever is earlier.



3 *Board committees*

Given the broad range of responsibilities of the board of directors, the constitution of committees enables effective governance through small group discussions, focus and diligence on various aspects. The key is to ensure an appropriate balance between the role delegated to a board committee while maintaining the overall supervisory role of the board, with key matters requiring prior recommendation of the relevant committee and final approval of the board.

The law already provides for several mandatory board committees with distinct roles and responsibilities, including the audit committee, stakeholder relationship committee, nomination and remuneration committee, corporate social responsibility committee, and for some companies, even a risk management committee.

The Committee recognised that the effective functioning of board committees is crucial for the board to successfully discharge its duties. Therefore, the Committee’s recommendations address fundamentals like balanced representation in board committees, mandating more focused discussion by setting a minimum number of meetings and a quorum for each such committee. Further, keeping in mind the changing operating environment, and expanding scope of roles and responsibilities of the board, the Committee also recommended an increase in the number and nature of board committees.

a. **Minimum number of committee meetings:** Audit committee to meet at least five times a year; nomination and remuneration committee, stakeholders relationship committee and risk management committee to meet at least once a year.

b. **Role of audit committee:** To include reviewing the utilisation of loans and/or advances from/investment by the holding company in the subsidiary exceeding 100 crore INR or 10% of the asset size of subsidiary, whichever is lower.

c. **Composition and role of nomination and remuneration committee:** Two-thirds of members to be IDs. The role to include recommending to the board all remuneration payable to senior management; meaning of senior management to include members of management one level below the chief executive officer/managing director/whole time director/manager (including chief executive officer/manager, in case the chief executive officer/manager is not part of the board) and specifically include company secretary and chief financial officer (administrative staff are not included).

d. **Composition and role of stakeholders relationship committee:** At least three directors to be members, with at least one being an ID. The chairperson to be present at the AGM to answer security holders’ queries. Further, the role of the committee has been detailed to include issue of new/duplicate certificates, general meetings; proactive communication and engagement with stockholders, including engagement with institutional shareholders at least once a year together with other committee members/board/key managerial personnel (KMP) as required and identifying points for implementation and review of various measures, initiatives taken by the committee with regard to shareholders.

e. **Quorum for committee meetings:** The quorum for the nomination and remuneration committee and stakeholders relationship committee to be either two members or one-third of the members of the committee, whichever is greater, with at least one ID.

f. **Applicability and role of risk management committee:** The risk management committee to be applicable to the top 500 listed entities and its function to include cyber security.

g. **Membership and chairpersonship limit:** The nomination and remuneration committee to also be considered for determining the limit, chairpersonship and membership of committees.

h. **Information technology committee:** As part of discretionary corporate governance requirements, listed entities may constitute an information technology committee which will focus on digital and technological aspects.

4 *Enhanced monitoring of group entities*

As companies grow in scale and operations become global, businesses become more complex. Business and structural requirements (both legal and financial) often necessitate the creation of holding and operating entities. The Committee noted that several listed entities in India operate through a network of entities—where some companies have over 200 subsidiaries, step-down subsidiaries, associates, and joint ventures. While investors hold direct equity only in the listed holding company, they have valued the entire business structure at the time of investment. Therefore, it is important for boards to ensure that good governance trickles down to the entire structure. Accordingly, to provide for better transparency on the governance levels of downstream investee entities of the listed entity and to improve the monitoring of the listed entity at a consolidated level, the Committee made the following recommendations:

a. **Obligation on the board of the listed entity with respect to subsidiaries:** The SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (SEBI LODR Regulations) impose specific obligations on the board of the listed entity with respect to its subsidiaries such as: at least one ID must be a director in unlisted material Indian subsidiaries; audit committee to review financial statements of unlisted subsidiaries; minutes of the board of directors of an unlisted subsidiary to be placed before a meeting of the board of directors of the listed entity. The SEBI LODR Regulations also provide the threshold for determining 'material subsidiary' as a subsidiary whose income or net worth exceeds 20% of the consolidated income or net worth of the listed entity.

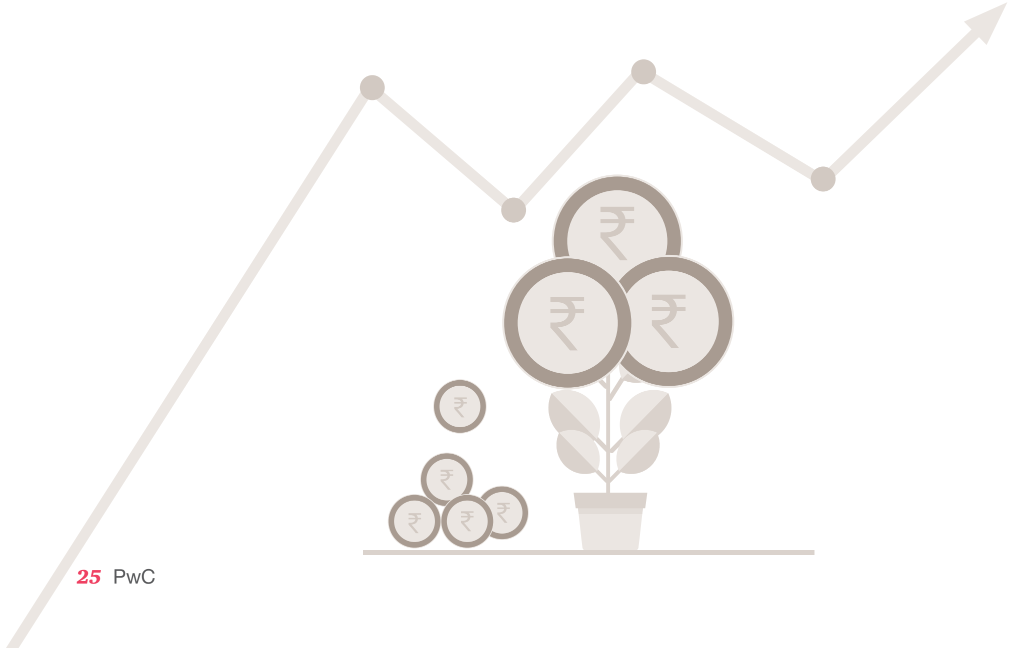
   The committee recommended amending the definition of 'material subsidiary' to include a subsidiary whose income or net worth exceeds 10% of the consolidated income or net worth respectively of the entity and its subsidiaries in the immediately preceding accounting year. For corporate governance requirements with respect to a subsidiary of a listed entity—at least one ID be a director on the board of the unlisted material subsidiary—material subsidiary to mean a subsidiary whose income or net worth exceeds 20% of the consolidated income or net worth respectively of the listed entity and its subsidiaries in the immediately preceding accounting year.

b. **Group governance unit/committee policy:** No amendments proposed to the SEBI LODR Regulations. However, the Committee recommended that guidance may be issued by SEBI stating the following where a listed entity has multiple unlisted subsidiaries:

   - The entity may monitor their governance through a dedicated group governance unit or governance committee comprising the members of its board of directors.
   - A strong and effective group governance policy may be established by the entity.
   - The decision of setting up such a unit/committee or having such a policy shall lie with the board of directors of the listed entity.

c. **Secretarial audit:** Currently, the 2013 Act requires a secretarial audit for listed companies and unlisted companies above a certain threshold. However, there is no specific provision for secretarial audit under the SEBI LODR Regulations. The Committee recommended that:

- Secretarial audit may be made compulsory for all listed entities under the SEBI LODR Regulations in line with the provisions of 2013 Act.
- Secretarial audit may also be extended to all material unlisted Indian subsidiaries.



5 *Accounting and audit-related issues*

Financial statements are the primary document that stakeholders (including investors, lenders, customers and suppliers) rely upon. These statements are intended and expected to depict the true nature of the business, and foretell its longevity. The Committee acknowledges that a good audit and appropriate levels of disclosure are prerequisites for reliable financial statements. After careful consideration, the Committee proposed certain recommendations with a view to improving disclosures and enhancing the quality of financial statements and audit. These include auditor's right to independently obtain external expert opinion, if not satisfied with the view or opinion of management/management's expert, quarterly financial disclosures to include standalone and consolidated results and cash flow statement to be published in the half-yearly results, disclosures on audit and non-audit services rendered by the auditor to the entity and its subsidiaries, addressing qualifications where the impact is not quantifiable.

a. **Audit qualifications:** With respect to audit qualifications, where the impact of the qualification is not quantifiable, management to mandatorily make an estimate and the auditor to review the same and report accordingly. Management may be permitted to not provide an estimate on matters like going concern or sub-judice matters, in which case it shall provide the reasons which the auditor to review and report accordingly.

b. **Independent external opinion by auditors:** If the auditor is not satisfied with the views/opinions of the management/management's expert, the auditor to have the right to independently obtain external opinions from experts at the entity's expense.

c. **Quarterly financial disclosures:**

   i. Listed entities with subsidiaries to submit standalone and consolidated quarterly results;

   ii. Cash flow statement to be published in the half-yearly results;

   iii. For consolidated results, at least 80% of each of the consolidated revenue, assets and profits, respectively, to be subjected to audit/limited review; and

   iv. The SEBI LODR Regulations currently state that the listed entity shall submit the audited financial results in respect of the last quarter along with the results for the entire financial year, with a note stating that the figures of the last quarter are the balancing figures between audited figures in respect of the full financial year and the published year-to-date figures up to the third quarter of the current financial year. The Committee recommended that any material adjustments made in the results of the last quarter which pertain to earlier periods should be disclosed by the listed entity as a note in the financial results.

d. **Disclosures on audit and non-audit services rendered by the auditor:** The corporate governance section of the annual report to contain total fees for all services paid by the listed entity and its subsidiaries to the statutory auditor and all entities in the network firm/network entity of which the auditor is a part.

e. **Disclosures of credentials and audit fee of auditors:** Notice of AGM where statutory auditor(s) is/are proposed to be appointed/reappointed to include disclosures on proposed fee payable and terms of appointment, and in case of a new auditor, details of material change in fee payable with rationale for change, basis of recommendation for appointment, including details and credentials of the statutory auditor proposed to be appointed.

f. **Ind AS adoption:** Timelines for Ind AS adoption for listed banks, non-banking financial companies (NBFCs) and insurance companies to be adhered to without extension.

g. **Strengthening monitoring, oversight and enforcement by SEBI:** Audit qualification to undergo detailed scrutiny and a mechanism to be devised wherein audit qualifications are examined in greater detail in a time-bound manner.

6 *Disclosures and transparency*

Disclosure and transparency underpin good governance and the efficient functioning of the markets. A corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, business performance, strategic shifts, ownership, and governance of the company. Regulations in India have driven a large part of the disclosure and transparency construct, especially for listed entities.

While companies, in general, comply with the regulatory minimum, the Committee highlighted the need to view disclosures and transparency as a means to build trust with stakeholders and to proactively disclose material information that may impact decision-making variables. Accordingly, the Committee proposed the following recommendations:

a. **Submission of annual reports:** Entity to publish on its website the copy of the annual report sent to shareholders along with the notice of AGM not later than the day of commencement of dispatch to shareholders. Where shareholders approve amendments to any portion of the annual report, the revised copy with details of and explanation for changes to be approved, to be sent no later than 48 hours after the AGM. Further, soft copies of the full annual report to be sent to shareholders who have registered their email addresses with the entity or with any depository.

b. **Disclosures pertaining to holders of depository receipts:** Statement of holding of securities and shareholding pattern to include details of names of holders of global depository receipts issued by the listed entity, if any, holding more than 1% of the total shareholding of the entity. Further, the listed entity to obtain information on holders of global depository receipts from overseas depository at least once every month.

c. **Disclosures pertaining to credit rating:** Website to include credit ratings obtained by the entity for all its outstanding instruments, updated immediately if there is any revision in the rating. The corporate governance report in the annual report to contain disclosures on the list of all credit ratings obtained by the entity, along with revisions during the financial year, for all debt instruments or fixed deposit programme or any scheme or proposal of the listed entity involving mobilisation of funds, whether in India or abroad.

d. **Searchable formats of disclosures:** Listed entities to make disclosures in soft copy to the stock exchanges in XBR format and in any searchable format on their websites.

e. **Harmonisation of disclosures:** The Committee noted that there is no specific provision under the 2013 Act or SEBI LODR regulations with respect to harmonised/standardised dissemination of disclosures made by the listed entities across websites of stock exchanges. Accordingly, the Committee recommended that (i) stock exchanges shall collectively harmonise the formats of the disclosures made by the listed entities on their respective websites; (ii) the stock exchanges shall move to disclosures by listed entities on exchange platforms in XBRL format in the latest available taxonomy; (ii) a common filing platform may be devised on which a listed entity may submit all filings, which could then be disseminated to all exchanges simultaneously.

f. **Disclosures pertaining to analyst/institutional investor meets:** Currently, the SEBI LODR Regulations require the disclosure of schedules for analyst or institutional investor meetings and presentations made by the listed entity to analysts or institutional investors on its website and to the stock exchange. The Committee recommended that the disclosure of schedules of analyst/institutional investor meetings does not serve any practical purpose, and there have been instances of its misuse. Hence, the Committee recommended that the disclosure of schedules of analyst/institutional investor meetings may not be required and the information to be shared at such meetings should be strictly in compliance with the SEBI (Prohibition of Insider Trading) Regulations.

g. **Disclosures of key changes in financial indicators:** Management discussion and analysis in the annual report to contain details of significant changes (change of 25% or more as compared to the previous financial year) in key financial ratios (such as debtor turnover and inventory turnover) along with detailed explanations. Further, it shall include details of change in return on net worth as compared to the previous financial year with detailed explanation thereof.

h. **Utilisation of proceeds of preferential issue and qualified institutional placement:** The corporate governance report in the annual report to contain utilisation of funds raised through preferential allotment or qualified institutional placements (QIPs) undertaken in the relevant financial year, until such funds are fully utilised.

i. **Disclosures in valuation reports in schemes of arrangement:** SEBI to consider amending its Circular on Schemes of Arrangement to include information in valuation reports, including specific disclosures on assets, liabilities and turnover of entities involved.

j. **Disclosures pertaining to directors:** The corporate governance section in the annual report to contain the names of the listed entities where the company's director is a director and the category of directorship.

k. **Disclosures pertaining to disqualification of directors:** The corporate governance report in the annual report to contain a certificate from the company secretary that none of the directors on the board have been debarred or disqualified from being appointed or continuing as directors of companies by SEBI/Ministry of Corporate Affairs (MCA) or any such statutory authority.

l. **Disclosures on website:** The website to have a separate section for investors to disseminate information.

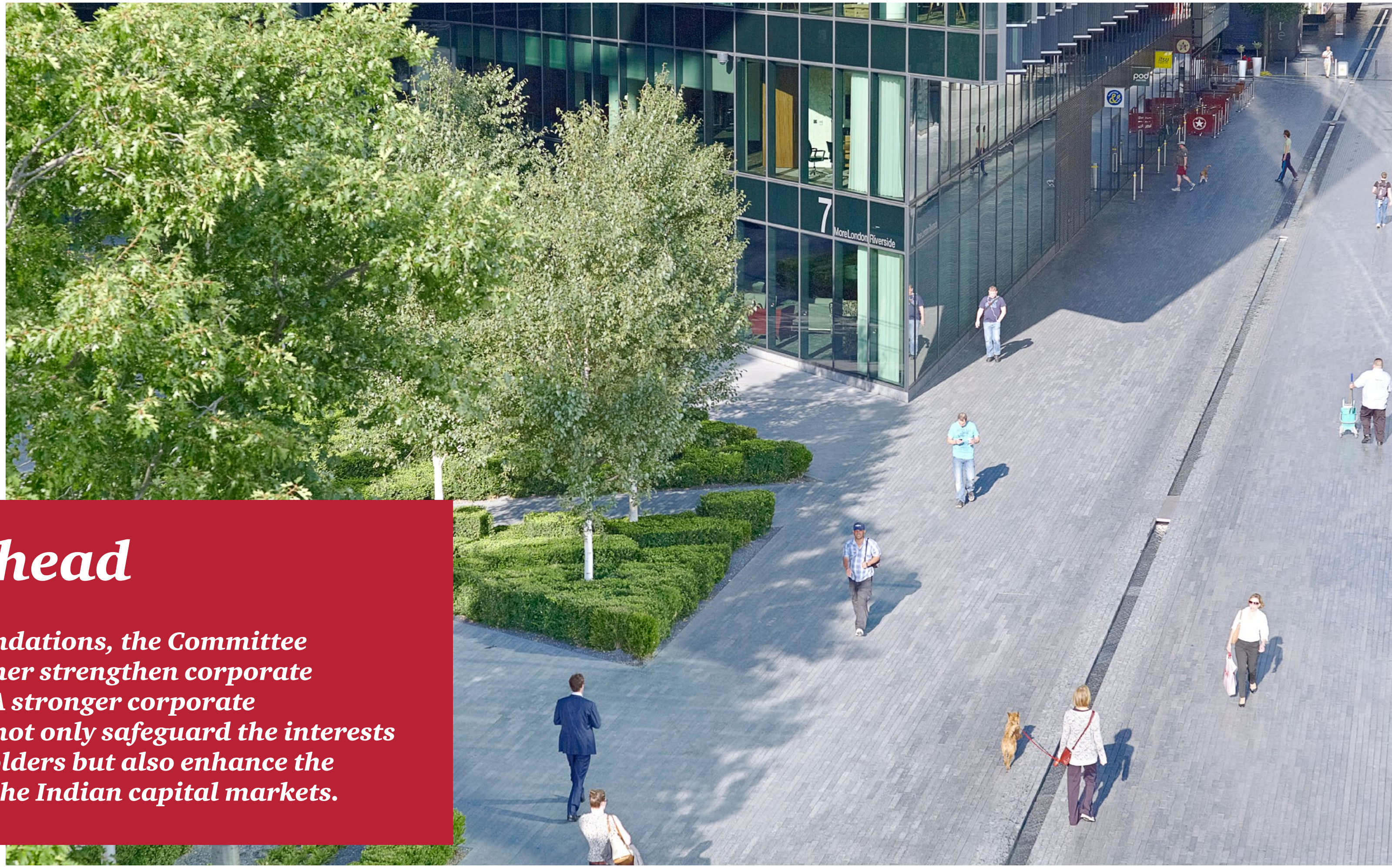
m. **Disclosures of subsidiary accounts:** Separate audited financial statements of each subsidiary of a listed entity in respect of a relevant financial year to be uploaded at least 21 days prior to the AGM.

n. **Disclosures on long-term and medium-term strategy:** The entity may disclose in the management discussion and analysis section of its the Annual Report, within the limits set by its competitive position, the medium- and long-term strategy based on a time frame determined by the board of directors.

o. **Prior intimation of board meeting to discuss bonus issue:** Currently, the SEBI LODR Regulations require prior intimation to the stock exchange about the meeting of the board of directors in which a proposal for the declaration of certain items, including bonus shares, is going to be discussed. The proviso to Regulation 29 of the SEBI LODR Regulations states that where the declaration of bonus by the listed entity is not on the agenda of the meeting of the board of directors, prior intimation is not required to be given to stock exchanges. The Committee noted that in view of the price-sensitive nature of bonus issues, advance notice for consideration of the bonus issue by the board should be required to be submitted to stock exchanges. Accordingly, it is recommended that the proviso to Regulation 29 in the SEBI LODR Regulations may be dropped.

p. **Views of committees not accepted by the board of directors:** Several provisions of the 2013 Act and the SEBI LODR Regulations require the committees of the board of directors (including the audit committee and the nomination and remuneration committee) to consider and recommend certain matters to the board of directors. However, except for section 177(8) of the Companies Act (in relation to the audit committee), there is no provision for disclosure to shareholders if the recommendations of the relevant committee are not accepted by the board. Accordingly, the Committee recommended that if the board of directors decides not to accept the recommendations of the statutory committees of the board, the same should be disclosed to shareholders on an annual basis along with the reasons thereof.

q. **Commodity risk disclosures:** Disclosures of commodity risks and other hedging activities is recommended and SEBI to consider issuing a circular in this regard.



Looking ahead

Through its recommendations, the Committee has attempted to further strengthen corporate governance in India. A stronger corporate governance code will not only safeguard the interests of the various stakeholders but also enhance the overall confidence in the Indian capital markets.

At a glance, US President Trump signed into law on 22 December 2017 extensive changes to the US tax system. These changes are substantively enacted for accounting purposes in 2017 and should be reflected in the financial statements at 31 December 2017. The tax law changes could have a significant impact on the current and deferred taxes of entities with a US tax presence. This article summarises the key changes and the IFRS tax accounting impact. Considering that Ind AS is substantially converged with IFRS, we believe that accounting impact discussed below would be equally relevant for Ind AS reporting companies.

Key changes to the US tax system and the IFRS tax accounting impact

Sr. no.	Tax Law changes	IFRS tax accounting impact
1	**Tax rate** The US federal corporate income tax rate is reduced from the existing rate of 35% to 21% with effect from 1 January 2018, regardless of the entity's tax year. Entities that do not have a 31 December reporting date will be subject initially to a pro-rated US federal corporate income tax rate that will apply to the first income tax year that ends after 31 December 2017. For example, a 30 June 2018 reporting date entity would apply a pro-rated US corporate tax rate of approximately 28%.	Deferred tax assets and deferred tax liabilities should be remeasured using the new tax rate, which will apply when the existing temporary differences reverse. Entities with non-calendar reporting dates may recognise the impact of the tax law changes in the interim period in which they were enacted. It is also acceptable to spread the effect over the remainder of the reporting period through the estimate of the annual effective tax rate for interim reporting periods. Entities with noncalendar reporting dates should also consider whether temporary differences reverse during a period when a pro-rated tax rate applies.

Sr. no.	Tax Law changes	IFRS tax accounting impact
2	**Repeal of alternative minimum tax (AMT)** AMT is repealed. AMT carry-forwards at 1 January 2018 can now be offset against regular tax, and any remaining balances will be refundable over the next four years.	Unrecognised deferred tax assets should be reassessed now that the carry-forwards are generally expected to be fully refundable. Entities should decide whether to reclassify AMT carry-forwards as a receivable. An entity might classify AMT carry-forwards as deferred tax assets if they will be recovered against future tax obligations, or as a receivable if they will be repaid in cash. There is an accounting policy choice of whether to discount current tax balances. The FASB staff have concluded that AMT carry-forwards should not be discounted under US GAAP, regardless of the expected manner of recovery.
3	**Changes in the way that net operating losses (NOLs) are recovered** NOLs generated after 2017 can be carried forward for an indefinite period, but generally cannot be carried back. Utilisation will be limited to 80% of taxable income in each year. There is no change to the rules applied to NOLs generated before the end of 2017	These changes might alter the assessment of the recoverability of deferred tax assets arising from NOLs. The changes will largely affect the recoverability of NOLs arising after 1 January 2018, but there could also be an impact on existing temporary differences that are expected to reverse into NOLs after that date.
4	**Interest expense limitation** The existing interest deduction limitations will be expanded. Interest deductions will be limited to 30% of adjusted taxable income. Interest not recovered in the year in which it is incurred can be carried forward indefinitely.	This will potentially create additional deferred tax assets that will need to be assessed for recoverability. Current-period interest will be deducted first, which might restrict an entity's ability to recognise deferred tax assets for interest deductions carried forward from previous periods in some cases.
5	**Cost recovery (full expensing)** Certain capital expenditure placed in service after 27 September 2017 and before 1 January 2023 may be written off immediately for tax purposes. Companies can also elect not to immediately write off qualifying assets.	This election might affect the current tax charge in 2017. It might create new taxable temporary differences in 2017 and additional deferred tax assets for tax loss carry-forwards (if a taxable loss is determined) that should be assessed for recoverability. Deferred tax liabilities and assets would be measured at the new lower tax rate that will apply when they reverse.

Sr. no.	Tax Law changes	IFRS tax accounting impact
6	**Territorial tax regime** International tax provisions change the US approach to the taxation of foreign earnings, including the transition to a 'territorial regime' providing a 100% dividend received deduction (DRD) on certain qualifying dividends from foreign subsidiaries.	The new rules might cause entities to reassess whether an existing outside basis difference will reverse in the foreseeable future and could affect the measurement of any deferred tax liability arising on investments in subsidiaries. Future dividends paid by foreign subsidiaries will not be taxed, but there could be withholding and other tax consequences imposed by the foreign jurisdiction on such dividends.
7	**Repatriation – toll charge** There will be a deemed mandatory repatriation of previously undistributed earnings and profits (E&P) of foreign corporations owned by U.S. parents. The rate applied depends on the subsidiaries' liquid and non-liquid assets. NOLs can be used to reduce the taxable income arising from the deemed repatriation and foreign tax credits (FTCs) can be used to settle the toll charge. The net charge can be paid in instalments over eight years.	There will be a current income tax liability in 2017 for the toll charge. There is an accounting policy choice of whether to discount current tax balances. The current tax liability might affect the recoverability of existing unrecognised deferred tax assets. The FASB staff have concluded that this liability should not be discounted under US GAAP.
8	**Taxation of foreign earnings** Certain global intangible low-taxed income (GILTI) of subsidiaries of US parents will be taxable income for the parent each year, based on the excess of foreign income over a specified return (deemed return on tangible assets of foreign corporations). This will result in a US tax on foreign earnings where: (i) there is not a large aggregate foreign fixed asset base; and (ii) foreign earnings are taxed at a low rate	It would be acceptable, under IFRS, to recognise the charge for GILTI in the year in which it is included on the tax return on the basis that it is triggered by the existence, on an aggregate basis, of 'excess' low-taxed foreign income in that year. It might also be acceptable to include the impact of the GILTI charge in the tax rate used to measure deferred taxes for temporary differences expected to reverse as GILTI. Judgement will be required to determine whether this is appropriate, and management should consider, for example, whether the entity is likely to be subject to the GILTI charge consistently, and whether it is possible to make a reliable estimate of its impact. Clear disclosure of the accounting model applied, the judgements made and the accounting impact should be given. The FASB staff have concluded that there is an accounting policy choice under US GAAP to either recognise GILTI as a period cost or include it in the measurement of deferred taxes.

Sr. no.	Tax Law changes	IFRS tax accounting impact
9	**Incentive for US production and selling abroad** An additional deduction for US companies that produce domestically and sell abroad has been introduced, referred to as Foreign Derived Intangible Income (FDII). The deduction is 37.5% (reduced to 21.875% for taxable years starting after 31 December 2025) for the portion of foreign-derived income in excess of a fixed return on qualifying business asset investment.	This type of deduction is not addressed specifically by IAS 12. Recognition in the year in which the deductions are included in the tax return would be an acceptable approach under IFRS, on the basis that it is foreign sales in each year that trigger the deduction. It might also be acceptable to include the impact in the tax rate used to measure deferred taxes on temporary differences that will be subject to FDII on reversal. Judgement is used to determine whether this is acceptable, and the decision will depend on an entity's specific facts and circumstances. Clear disclosure of the accounting model applied, the judgements made and the accounting impact should be given. In our view, FDII should be accounted for as a special deduction under US GAAP and recognised in the year in which the deduction is claimed.
10	**Foreign tax credits (FTCs)** There are significant modifications to the FTC provisions, and certain indirect FTCs are repealed.	This might affect the assessment of recoverability of deferred tax assets related to FTCs.
11	**Anti-base erosion – minimum tax on certain related party payments** A minimum tax, known as BEAT, will be paid when the tax calculation under BEAT exceeds the corporation's regular tax liability (after the application of certain credits). BEAT is a modified taxable income after adding back base erosion payments, such as payments to related foreign persons (generally excluding payments for cost of goods sold).	The FASB staff have concluded that temporary differences should be measured at regular tax rates and the effects of BEAT should therefore be accounted for in the year in which it is incurred. This approach would be acceptable under IFRS.

Recognition of the remeasurement of deferred taxes

IFRS requires the remeasurement of deferred taxes to be recorded outside profit or loss if the deferred tax relates to items previously recognised in other comprehensive income or equity, which is commonly referred to as 'backwards tracing'. It might sometimes be difficult to determine how to allocate the remeasurement. For example, a change in tax rate might affect a deferred tax balance that was previously recognised partly outside profit or loss (for example, in connection with an employee benefit liability). A reasonable pro rata allocation, or other suitable method that achieves a more appropriate allocation, can be used to reflect an entity's circumstances.

Judgements and estimates

The calculations and assessments required by the changes in US tax law are complex, and some entities might find it difficult to complete the analysis before the 2017 financial statements are issued. Challenges will include the time needed to complete and collate the data for the calculations, the actual application of the new law and understanding some of the accounting implications. Management should do its best to make a reliable estimate of the accounting impact of each aspect of the tax law changes, taking into account 'reliable information that could reasonably be expected to have been obtained and taken into account', together with the entity's existing approach to uncertain tax positions. Subsequent adjustments would typically be accounted for as a change in estimate. In almost all cases, management should be able to make a reliable estimate. Entities should also present all of the required relevant disclosures, including those required by IAS 12, Income Taxes and also disclosures on judgements and estimation uncertainties required by paragraphs 125–133 of IAS 1, *Presentation of Financial Statements*.

Other accounting considerations

The tax law changes might have other accounting consequences. These might affect, for example, hedge accounting, impairment testing and liquidity disclosures. The extent of the impact and the areas affected will depend on a company's particular circumstances.

The change

The FASB issued Accounting Standards Update (ASU) 2017-01 which revises the definition of a business. The changes to the definition of business will likely result in more acquisitions being accounted for as asset acquisition. The definition of a business also affects many areas of accounting, including disposals, consolidation and segment changes.

When substantially all of the fair value of gross assets acquired is concentrated in a single asset (or a group of similar assets), the assets acquired would not represent a business. The amendment introduces this initial required screen that, if met, eliminates the need for further assessment.

To be considered as a business, an acquisition should include an input and a substantive process that together significantly contribute to the ability to create outputs. The new guidance provides a framework to evaluate when an input and a substantive process are present.

The new guidance narrows the definition of the term 'outputs'. Under the new definition, an output is the result of inputs and substantive processes that provide goods or services to customers, other revenue, or investment income such as dividends and interest.

Applicability

For public companies, the ASU is effective for annual periods beginning after 15 December 2017, including interim periods within those periods. For all other companies and organisations, the ASU is effective for annual periods beginning after 15 December 2018, and interim periods within annual periods beginning after 15 December 2019.

Key consideration

The amendment provides a screen to determine when an acquisition is not a business, through a two-step approach to conclude on the asset or business acquisition. Entities can now save significant time and efforts on analysing acquisition transactions if they fail the initial screen test.

Two-step approach:

Initial step: If substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar identifiable assets, *the set is not a business*. If the answer to this initial step is no, entities are required to proceed with the evaluation as follows.

Subsequent step: In case the screen is not met, then for a set to be considered as a *business*, it must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output.

This amendment has removed the evaluation of whether a market participant could replace missing elements. The amendments provide a framework to assist entities in evaluating whether both an input and a substantive process are present.

In contrast to the current definition of business, under the updated definition, the acquired set would need to have its own inputs and a substantive process that together would create an output for an acquisition to qualify as a business.

Although outputs are not required for a set to be a business, they are generally a key element of a business, therefore, the board has developed more stringent criteria for sets without outputs.

Illustration 1:

Pharma Co. purchases from Biotech, a legal entity that contains the rights to a Phase 3 (in the clinical research phase) compound being developed to treat diabetes (the in-process research and development project). Included in the in-process research and development project are the historical know-how, formula protocols, designs, and procedures expected to be needed to complete the related phase of testing.

The legal entity also holds an at-market clinical research organisation contract and an at-market clinical manufacturing organisation contract. No employees, other assets or other activities are transferred.

Pharma Co. first considers the guidance to conclude that the in-process research and development project is an identifiable intangible asset that would be accounted for as a single asset in a business combination. Pharma Co. also qualitatively concludes that there is no fair value associated with the clinical research organisation contract and the clinical manufacturing organisation contract because the services are being provided at market rates and could be provided by multiple vendors in the marketplace. Therefore, all of the consideration in the transaction will be allocated to the in-process research and development project. As such, Pharma Co. concludes that substantially all of the fair value of the gross assets acquired is concentrated in the single in-process research and development asset and the set is not a business.

Illustration 2:

ABC acquires, renovates, leases, sells and manages real estate properties. ABC acquires a portfolio of 10 single-family homes that each have in-place leases. The only elements included in the acquired set are the 10 single family homes and 10 in-place leases. Each single-family home includes land, building and property improvements. Each home has a different floor plan, square footage, lot and interior design. No employees or other assets are acquired.

ABC first considers the guidance to conclude that the land, building, property improvements and in-place leases at each property can be considered a single asset. That is, the building and property improvements are attached to the land and cannot be removed without incurring significant cost. Additionally, the in-place lease is an intangible asset that should be combined with the related real estate and considered a single asset.

ABC also concludes that the 10 single assets (the combined land, building, in-place lease intangible and property improvements) are similar. Each home has a different floor plan; however, the nature of the assets (all single-family homes) is similar. ABC also concludes that the risks associated with managing and creating outputs are not significantly different. That is, the risks associated with operating the properties and tenant acquisition and management are not significantly different because the types of homes and class of customers are not significantly different. Similarly, the risks associated with operating in the real estate market of the homes acquired are not significantly different. Consequently, ABC concludes that substantially all of the fair value of the gross assets acquired is concentrated in the group of similar identifiable assets. Thus, the set is not a business.

Comparison of the changes with the IFRS?

In June 2016, the IASB issued an exposure draft proposing to clarify the definition of a business under IFRS 3, *Business Combinations*. The proposed amendments are substantially the same as the amendments by the FASB in ASU 2017-01. A key distinction is the screen test, which is required under the US GAAP but is optional in the IASB’s proposal. The proposed amendments will likely result in more acquisitions being classified as asset acquisitions. However, the impact on IFRS is expected to be less significant compared to that on US GAAP. Final amendments to IFRS 3 are expected in the first half of 2018.

The International Accounting Standards Board (IASB) issued 'Annual Improvements to IFRS Standards 2015–2017 Cycle' in December 2017. These are minor amendments affecting IFRS 3, 'Business combinations', IFRS 11, 'Joint arrangements', IAS 12, 'Income taxes' and IAS 23, 'Borrowing costs'.

Overview of the amendments

Clarifying measurement of previously held interest in obtaining control over a joint operation under IFRS 3

The amendments clarified that obtaining control of a business that is a joint operation is a business combination achieved in stages. The acquirer should remeasure its previously held interest in the joint operation at fair value as of the acquisition date. The amendments are effective for business combinations with acquisition date on or after the beginning of annual periods beginning on or after 1 January 2019. Earlier application is permitted.

Clarifying measurement of previously held interest in obtaining joint control over a joint operation under IFRS 11

The amendments clarified that the party obtaining joint control of a business that is a joint operation should not remeasure its previously held interest in the joint operation. The amendments are effective for transactions resulting in obtaining joint control on or after the beginning of annual periods beginning on or after 1 January 2019. Earlier application is permitted.

Income tax consequences under IAS 12 of payments on financial instruments classified as equity

The amendment clarified that the income tax consequences of dividends on financial instruments classified as equity should be recognised according to where the past transactions or events that generated distributable profits were recognised. These requirements apply to all income tax consequences of dividends. Previously, it was unclear whether the income tax consequences of dividends should be recognised in profit or loss, or in equity, and the scope of the existing guidance was ambiguous. The IASB noted that the amendments do not suggest that an entity recognises in profit or loss the income tax consequences of all payments on financial instruments classified as equity. Rather, the tax consequences are recognised in profit or loss only when an entity determines payments on such instruments are distributions of profits (that is, dividends). An entity may need to apply judgement in making this determination. These amendments should be applied for annual periods beginning on or after 1 January 2019 to the income tax consequences of dividends recognised on or after the beginning of the earliest comparative period. Earlier application is permitted.

Under Ind AS, the ICAI Accounting Standard Board (ASB) has issued an FAQ on accounting treatment of dividend distribution tax (DDT). As per the FAQ, presentation of DDT should be consistent with the presentation of dividend. Since dividend paid on equity instruments is presented in equity, DDT should also be presented in equity. As per the amendment to IAS 12, income tax consequences of payments which are classified as distributions of profits (i.e. dividends) are recognised in profit or loss. Companies with IFRS reporting need to evaluate the presentation of DDT in light of the amendment to IAS 12.

Borrowing costs eligible for capitalisation under IAS 23

The amendments clarified that if a specific borrowing remains outstanding after the related qualifying asset is ready for its intended use or sale, it becomes part of general borrowings. These amendments should be applied prospectively for borrowing costs incurred on or after the beginning of annual periods beginning on or after 1 January 2019. Earlier application is permitted.

Next steps:

The above amendments are effective for annual reporting periods beginning on or after 1 January 2019 with earlier application permitted. Entities with IFRS reporting should analyse the amendments and evaluate the impact on their accounting policies.

Institute of Chartered Accountants of India (ICAI)

Accounting Standards Board (ASB)

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

The ASB of the ICAI issued an exposure draft of amendments to Ind AS 20. Among other matters, the exposure draft proposes to amend Ind AS 20 to incorporate the accounting alternative (i) to measure non-monetary government grants at nominal value and (ii) to present government grants related to assets in the balance sheet by deducting the grant from the carrying amount of the asset. These amendments are proposed to be applicable for the annual periods beginning on or after 1 April 2018, subject to notification of the Ministry of Corporate Affairs. Comments on the exposure draft may be submitted by 24 January 2018.

Ind AS Transition Facilitation Group (ITFG) Bulletin 12

The ITFG issued its 12th bulletin to address certain issues received from preparers and other stakeholders. The clarifications from the 12th bulletin are summarised below:

1. Immovable property such as land or building which meets the definition of property, plant and equipment (PP&E) as per Ind AS 16, 'Property, plant and equipment', shall be subsequently measured at cost or revaluation model. If an item of PP&E is revalued, the entire class of PP&E to which that asset belongs needs to be revalued. Immovable properties which meet the definition of investment property as per Ind AS 40, 'Investment property', shall be subsequently measured at cost only.
2. Where a first-time adopter of Ind AS has elected to apply fair value as the deemed cost of an item of PP&E, then government grant related to that asset needs to be recognised on the date of transition by setting up the grant as deferred income. The resulting adjustment will be made in retained earnings or, if appropriate, another category of equity at the date of transition to Ind AS.
3. Para D7AA of Ind AS 101, 'First-time adoption of Ind AS', permits an entity to continue with previous Indian GAAP carrying values as the deemed cost for all of the items of PP&E. Any intra-group profits or losses forming part of the deemed cost need to be eliminated while preparing consolidated financial statements of the parent entity.

4. The previous GAAP carrying value used as the deemed cost under Ind AS 101 can only be adjusted for those adjustments which are consequential and arise as a result of applying the transition requirements of Ind AS 101.
5. Where a loan borrowed from one bank has been prepaid by availing of a new loan from another bank, the prepayment would result in extinguishment of the old loan. The prepayment premium paid shall be recognised in profit or loss as part of the gain or loss on extinguishment of the loan. Loan processing fees paid on the origination of the new loan will be included in the computation of the effective interest rate (EIR) of the new loan.
6. The branch office of a foreign company established in India is not incorporated under the Indian Company Law. It is only an establishment of a foreign company in India. The branch office is just an extension of the foreign company in India. Accordingly, the branch office of a foreign company is not required to comply with Ind AS.
7. Where a first-time adopter has applied the exception under para B10 of Ind AS 101, then it shall not recognise the benefit of government loan at below-market rate of interest as a government grant with respect to government loans existing on the date of transition. The previous Indian GAAP carrying amount of the government loan on the date of transition shall be the carrying amount under Ind AS. The exception available under para B10 of Ind AS 101 also applies to sales tax deferral schemes.
8. Entities should evaluate the terms and conditions of the comfort letter to assess whether it can be considered as a financial guarantee as per Ind AS 109, 'Financial Instruments'. A comfort letter shall be accounted for as a financial guarantee contract if it creates a contractual obligation to make specified payments to the holder of the guarantee in case of default by the specified debtor.
9. Financial guarantee issued shall be initially recognised at fair value. Where the financial guarantee has been issued on arm's-length terms, fair value is likely to be equal to the commission received. Financial guarantee should subsequently be measured at the higher of the amount of loss allowance as per Ind AS 109 and the amount initially recognised less cumulative amount of income recognised in accordance with Ind AS 18, 'Revenue'.
10. Where a first-time adopter has availed of the business combination exemption under Appendix C of Ind AS 101, the deemed cost of the financial assets and liabilities (acquired as part of the past business combination) for Ind AS shall be their carrying amounts in accordance with the previous Indian GAAP immediately following the business combination.
11. Where the date from which the amalgamation is proposed to be effected in the books of the accounts of the amalgamated company is different from the acquisition date as per Ind AS 103, 'Business combinations', the auditor shall state this fact in the certificate as required to be issued under section 232 (3) of the Companies Act, 2013. If the National Company Law Tribunal (NCLT) approves the scheme of amalgamation with a different appointed date as compared to the acquisition date as per Ind AS 103, the appointed date approved by the NCLT will be the acquisition date.

Refer link to access our detailed publication on ITFG Bulletin 12:
https://www.pwc.in/assets/pdfs/publications/2017/pwc-reportinginbrief-itfg-bulletin-12.pdf

Expert Advisory Committee Opinion

The Expert Advisory Committee (EAC) of the ICAI published an opinion clarifying whether deferred debts in the nature of retention money need to be discounted under Ind AS. The facts of the case and opinion are summarised below:

Facts of the case:

1. ABC Ltd is an integrated power plant equipment manufacturer engaged in designing, engineering, manufacture, construction, testing and commissioning of power projects.
2. The projects have a long gestation period where the normal execution period of a contract ranges between 3 to 5 years.
3. Progress billing contains a retention element which ranges from around 5% to 10% of the bill amount. The retention money will become contractually due for payment by the customer on the happening of certain events such as trial operation and performance of guarantee tests.

Query:

Should deferred debts in the nature of retention money be discounted?

Opinion:

The EAC opined that where the effect of the time value of the money is material, deferred debts in the nature of retention money should be discounted in order to arrive at the fair value of the consideration receivable from the contract in accordance with para 12 of Ind AS 11, 'Construction contracts'.

Quality Review Board

The Quality Review Board of the ICAI has issued a Report on Audit Quality Review, providing findings, analysis and a summary of observations made by the Technical Reviewers in review reports during the period 2016–2017 relating to compliance with standards on auditing, accounting standards, other relevant laws and regulations.

***Refer link** http://www.qrbca.in/wp-content/uploads/2017/11/qrb37506.pdf for the report of quality review board.*

Committee on International Taxation

The Committee on International Taxation of the ICAI has issued the Guidance Note on report under section 92E of the Income-tax Act, 1961 (Transfer Pricing) (Revised 2017). This guidance note is based on the law as amended by the Finance Act, 2017.

Insurance Regulatory and Development Authority of India (IRDAI)

Working Group on the New Standard on Insurance Contracts (equivalent to IFRS 17, Insurance Contracts)

The IRDAI had constituted a working group on a new standard equivalent to IFRS 17, Insurance Contracts. In order to enable a more detailed examination of the provisions contained in IFRS 17 by the working group, the IRDAI has decided to extend the time limit for review up to 30 June 2018.

Securities and Exchange Board of India (SEBI)

SEBI Board Meeting

The SEBI Board held its meeting on 28 December 2017. Among other matters, the SEBI Board approved the following:

1. SEBI (Listing Obligations and Disclosure Requirements), 2015 shall be amended to include:
   a. Disclosure of financial results on the Exchange(s) by issuers of listed debt in line with the corresponding requirements for issuers of listed equity.Issuers of listed debt shall disclose on the Exchange(s) within forty-five days of the end of the first three quarters and sixty days of the end of the last quarter, the below mentioned financial results in the format as prescribed in Schedule III to the Companies Act, 2013 (excluding notes and detailed sub-classification):
      i. Statement of profit and loss on a quarterly and year-to-date basis
      ii. Statement of assets and liabilities/balance sheet on a half-yearly basis
   b. Disclosure of annual consolidated financial results to the Exchange(s) in case of issuers having only listed debt. Issuers of listed debt shall disclose their audited annual consolidated financial results on the Exchange(s) within sixty days from the end of the financial year.

2. Changes in the SEBI (Credit Rating Agencies) Regulations, 1999, in order to augment the governance of Credit Rating Agencies (CRAs) registered with SEBI and mitigate the issues of conflict of interest.
3. Additional methods for listed entities to achieve minimum public shareholding.
4. Norms for shareholding and governance in mutual funds.

Enhancing fund governance for mutual funds (MFs)

SEBI issued a circular dated 30 November 2017 to enhance the governance structure for mutual funds. Among other matters, the circular stated that:

i. An independent trustee and ID shall hold office for a maximum of 2 terms with each term not exceeding a period of 5 consecutive years.

ii. No independent trustee or IDs hall hold office for more than two consecutive terms; however, such individuals shall be eligible for re-appointment after a cooling-off period of 3 years. During the cooling-off period, such individuals should not be associated with the concerned MF, asset management company (AMC) and its subsidiaries and/or sponsor of AMC in any manner whatsoever.

iii. No MF shall appoint an auditor for more than 2 terms of maximum 5 consecutive years. Such auditor may be re-appointed after a cooling-off period of 5 years.

iv. Further, during the cooling-off period of 5 years, the incoming auditor may not include:

   a. Any firm that has common partner(s) with the outgoing audit firm;

   b. Any associate/affiliate firm(s) of the outgoing audit firm which are under the same network of audit firms wherein the term 'same network' includes the firms operating or functioning, hitherto or in future, under the same brand name, trade name or common control.

Reserve Bank of India (RBI)

Foreign investment in India – rationalisation

The Foreign Exchange Management Act, 1999 (FEMA), governs foreign investment into India. One of the key regulations under FEMA, which deals with foreign investment into India, is FEMA Notification No. 20 (Foreign Exchange Management [Transfer or Issue of Security by a Person Resident Outside India] Regulations, 2000). The RBI has revised FEMA 20 and the key highlights of the revised notification are as follows:

1. Issue of capital instruments

- Equity instruments, i.e., equity shares (including partly paid-up shares), debentures, preference shares and share warrants, have now been clubbed under one definition of 'capital instruments'.
- Foreign direct investment has been defined to mean investment through capital instruments by a person resident outside India in an unlisted Indian company, or in 10% or more in a listed Indian company.
- Foreign portfolio investment (FPI) means any investment made by a person resident outside India, where such investment is less than 10% of the post issue paid-up share capital on a fully diluted basis of a listed Indian company.
- Under the erstwhile regulation, general permission was available to issue shares upon merger/demerger/amalgamation, subject to prescribed conditions. Under the revised regulation, Indian companies can now issue any capital instrument pursuant to merger/demerger/amalgamation, subject to prescribed conditions.
- The timeline of issue of capital instruments has been aligned with the Companies Act, 2013. The period was 180 days under the erstwhile regulations. In case of non-issuance of capital instruments within 60 days, money will be required to be refunded within 15 days.
- It has been clarified that foreign investment has to be calculated under a fully diluted basis—that is, the total number of shares that would be outstanding if all possible sources of conversion are exercised.
- For computation of limits applicable to FPI (i.e. less than 10%), investment by investor group (i.e. the same set of ultimate beneficial owners investing through multiple entities) to be considered.

2. Transfer of capital instruments

The following transfers have now been permitted under the automatic route:

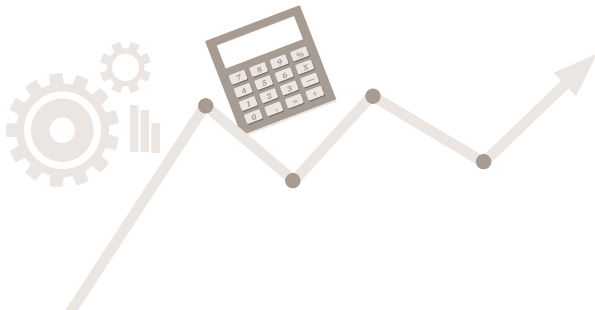
- Transfer by non-resident of India (NRI) or OCI to a person resident outside India by way of sale or gift subject to prescribed conditions;
- Transfer from person resident outside India to another person resident outside India pursuant to liquidation, merger, demerger, amalgamation of foreign companies.

3. NRI

Consequent changes made in various regulations in relation to investment under Schedule 4 (NRI on non-repatriation basis) considered as investment by resident.

4. Other key highlights

- Foreign investment in commodities spot exchange has been permitted up to 49% under the automatic route.
- The definition of 'downstream investment' has been amended to include investment by the limited liability partnership (LLP)/ investment vehicle in downstream Indian company or LLP.
- The RBI permitted to prescribe late payment fee for delay in reporting to it.



Ministry of Corporate Affairs (MCA)

Companies (Amendment) Act, 2017

The Companies (Amendment) Bill, 2017, which was passed by the Lok Sabha in June 2017 and Rajya Sabha in December 2017 obtained the assent of the President of India on 3 January 2018. For the overview of the Companies (Amendment) Bill, 2017, refer to the link of our previous edition of PwC ReportingPerspectives:

https://www.pwc.in/assets/pdfs/publications/2017/pwc-reportingperspectives-october-2017.pdf

Companies (Filing of Documents and Forms in Extensible Business Reporting Language), Amendment, Rules, 2017

The MCA has notified the Companies (Filing of Documents and Forms in Extensible Business Reporting Language), Amendment, Rules, 2017. The rules require the following classes of companies to file their financial statements and other documents under section 137 of the Companies Act, 2013 with the Registrar in e-form AOC-4 (XBRL):

- Companies listed with stock exchanges in India and their Indian subsidiaries;
- Companies having paid up capital of 5 crore INR or above;
- Companies having a turnover of 100 crore INR or above; and
- All companies that are required to prepare their financial statements in accordance with the Companies (Indian Accounting Standards) Rules, 2015.

Non-banking financial companies, housing finance companies and companies engaged in the business of banking and insurance are exempted from filing of financial statements under these rules.

The MCA vide general circular no. 13/2017 dated 26 October 2017 also extended the due date for XBRL filing for Ind AS compliant companies to 31 March 2018.

Companies (Registered Valuers and Valuation) Rules, 2017

The MCA appointed 18 October 2017 as the date on which section 247 of the Companies Act, 2017, relating to valuation by registered valuers, shall come into force. The MCA also notified the Companies (Registered Valuers and Valuation) Rules, 2017. These rules provide the criteria for eligibility, qualifications and registration of valuers, recognition of valuer organisations and related compliance matters. It also provides that the Central Government shall notify and may modify (from time to time) the valuation standards.

IASB: IFRS

Narrow scope amendments to IFRS 9 and IAS 28

The IASB has issued amendments to IFRS 9, Financial Instruments, and to IAS 28, Investments in Associates and Joint Ventures, to aid implementation.

The amendments to the financial instruments Standard, IFRS 9, allow companies to measure particular pre-payable financial assets with so-called negative compensation at amortised cost or at fair value through other comprehensive income if a specified condition is met—instead of at fair value through profit or loss.

The amendments to IAS 28, Investments in Associates and Joint Ventures, clarify that entities are to account for long-term interests in an associate or joint venture—to which the equity method is not applied—using IFRS 9.

The Board also confirmed the accounting for modifications of financial liabilities under IFRS 9. That is, when a financial liability measured at amortised cost is modified without this resulting in derecognition, a gain or loss should be recognised in profit or loss. The gain or loss is calculated as the difference between the original contractual cash flows and the modified cash flows discounted at the original effective interest rate.

IFRS IC decision on interest and penalties related to income taxes

The IFRS Interpretations Committee (IC) issued an agenda decision in September 2017 on interest and penalties related to income taxes.

IFRIC 23, 'Uncertainty over income tax treatments', applies to income taxes within the scope of IAS 12, 'Income taxes'. It does not address the accounting for interest and penalties. The IC considered whether it should develop guidance. The IC concluded that the benefits of improvements in financial reporting from a project to consider interest and penalties would not outweigh the costs. It therefore decided that it should not develop guidance, and it issued an agenda decision.

The IC observed in the agenda decision that entities do not have an accounting policy choice between applying IAS 12 and applying IAS 37, 'Provisions, contingent liabilities and contingent assets', to interest and penalties related to income taxes. If an entity considers that a particular amount payable or receivable for interest and penalties is an income tax, IAS 12 is applied to that amount. If an entity does not apply IAS 12 to an amount payable or receivable for interest and penalties, it applies IAS 37 to that amount.

The IC also observed that:

- An entity discloses its judgement in this respect by applying paragraph 122 of IAS 1, 'Presentation of financial statements', if it has a significant effect on the amounts recognised in the financial statements; and
- Regardless of whether an entity applies IAS 12 or IAS 37 when accounting for interest and penalties related to income taxes, the entity discloses information about those items if material, because both IAS 12 and IAS 37 provide disclosure requirements.

US GAAP: FASB

FASB proposes to simplify the new leases guidance

On 29 November 2017, the FASB voted to propose amendments to the new leases guidance to add two practical expedients. The proposed changes would allow entities to elect a simplified transition approach, and provide lessors with an option related to how lease and other related revenues are presented and disclosed.

When adopting the new leasing guidance, lessees are currently required to recognise and measure leases at the beginning of the earliest period presented in their financial statements, using a modified retrospective approach. Lessors may also be required to make certain transition adjustments as of the beginning of the earliest period presented in their financial statements. For example, a public company lessee adopting the new leasing guidance for its year beginning 1 January 2019 would measure and recognise leases as of 1 January 2017.

At its 29 November 2017 meeting, the FASB proposed allowing entities the option to instead apply the provisions of the new leases guidance at the effective date (e.g. 1 January 2019), without adjusting the comparative periods presented. The proposal could simplify transition to the new guidance. For example, a lessee would not have to measure and recognise leases that expired prior to the effective date, or consider the effects of each modification for leases that were modified more than once during the comparative period presented.

The FASB also voted to simplify the reporting and disclosures for lessors for certain leases in which they also provide related services. Lessors often provide services to lessees in addition to the leased asset itself. For example, under many real estate and equipment leases, the lessor also provides maintenance services for the leased property. Under the new leasing guidance, entities are required to separate the lease and non-lease components, and account for the non-lease component under other applicable guidance (e.g. under the revenue guidance). The new leasing guidance currently allows lessees—but not lessors—a practical expedient to not separate the non-lease components, but, rather, to account for the entire arrangement as a lease. The FASB proposes to allow lessors to elect, under certain circumstances, a similar practical expedient—that is, to allow lessors to not separate the non-lease components from the lease. A lessor could elect this practical expedient when the pattern of income recognition for the lease and non-lease components are identical, and when the lease would continue to be classified as an operating lease even if all of the contract consideration is accounted for as rents. The proposed practical expedient would alleviate many of the complexities related to separating components and allocating consideration between them, without changing the timing of revenue recognition.

The proposed amendments would have the same effective date as the new leases standard. For public business entities, the proposed rules would be effective for annual reporting periods beginning after 15 December 2018. Other entities would have an additional year.

Accounting Standards Update (ASU) No. 2017-13, Revenue Recognition (Topic 605), Revenue from Contracts with Customers (Topic 606), Leases (Topic 840), and Leases (Topic 842): Amendments to SEC Paragraphs Pursuant to the Staff Announcement at the July 20, 2017 Emerging Issues Task Force (EITF) Meeting and Rescission of Prior SEC Staff Announcements and Observer Comments (SEC update)

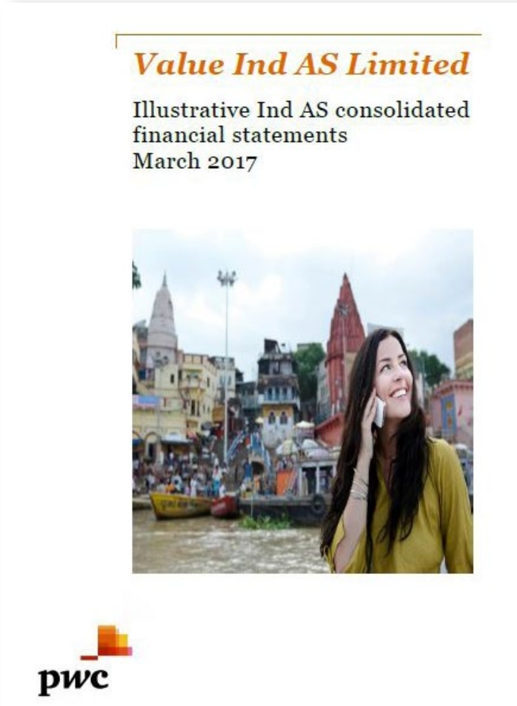
On 20 July 2017, the SEC staff announced that it would not object when certain public business entities (PBEs) elect to use the non-PBE effective dates solely to adopt the FASB's new standards on revenue (ASC 606) and leases (ASC 842) at the EITF meeting. The ASU reflects comments made by the SEC.

Accounting Standards Update (ASU) No. 2017-15, Codification Improvements to Topic 995, U.S. Steamship Entities – Elimination of Topic 995.

This ASU supersedes the guidance for steamship entities in ASC 995 with respect to 'unrecognized deferred taxes related to certain statutory reserve deposits'. The ASU requires entities with 'unrecognized deferred income taxes related to statutory deposits made on or before December 15, 1992' to recognise the unrecognised income taxes in accordance with ASC 740.

Publications (1/3)

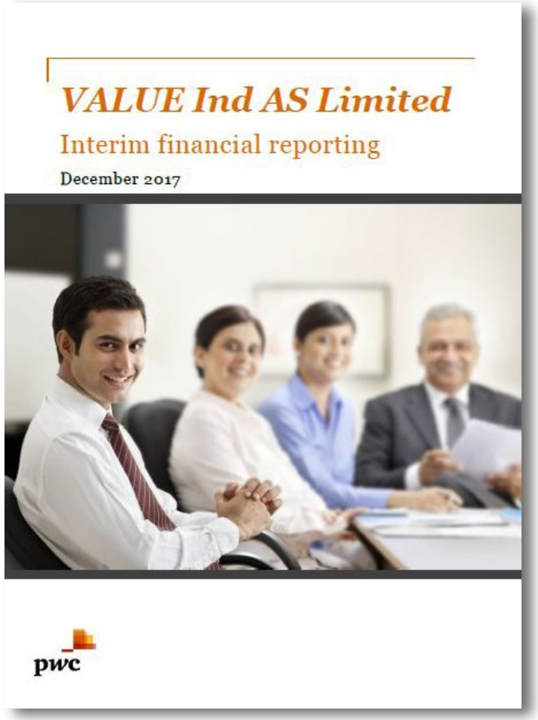
http://www.pwc.in/assets/pdfs/publications/2017/pwc-ind-as-impact-analysis-corporate-indias-transition-to-ind-as.pdf



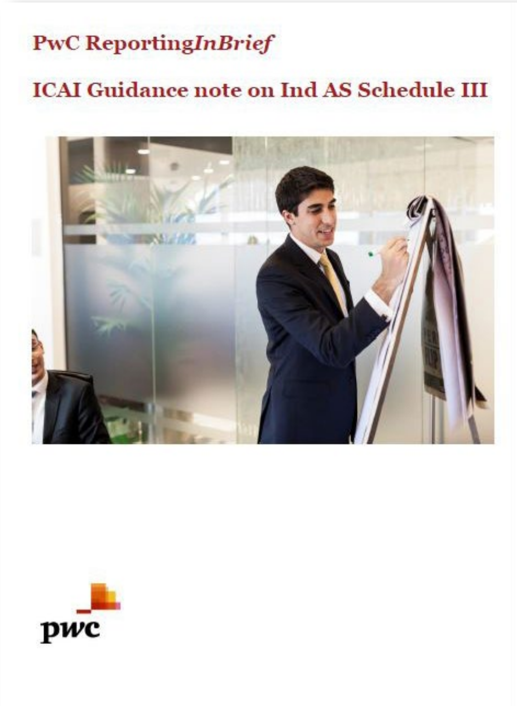
https://www.pwc.in/assets/pdfs/services/ifrs/illustrative-ind-as-consolidated-financial-statements-march.pdf

https://www.pwc.in/assets/pdfs/publications/2017/ind-as-presentation-and-disclosure-checklist-2017.pdf

Publications (2/3)



https://www.pwc.in/assets/pdfs/services/ifrs/illustrative-interim-financial-reporting-december-2017.pdf



https://www.pwc.in/assets/pdfs/publications/2017/pwc-reportinginbrief-icai-guidance-note-on-ind-as-schedule-iii.pdf

https://www.pwc.in/assets/pdfs/publications/2017/pwc-reportinginbrief-itfg-bulletin-12.pdf

Publications (3/3)

https://www.pwc.in/assets/pdfs/publications/2017/ifrs-us-gaap-ind-as-and-indian-gaap-similarities-and-differences.pdf

https://www.pwc.in/assets/pdfs/publications/2017/pwc-reportingperspectives-october-2017.pdf

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