Carve-Outs/Ins in IFRS-Converged Indian Accounting Standards: Recent Developments

The IFRS-converged Indian Accounting Standards (Ind ASs) depart from the corresponding IFRSs to maintain consistency with legal, regulatory and economic environment. In some cases, departures are made on account of conceptual differences with the treatments prescribed in the IFRSs. The ICAI while carrying out the process of convergence with IFRSs always attempts to keep these departures to the minimum and these are also taken forward and discussed with the IASB from time to time. Recently, these carve outs/ins have been examined and revised corresponding to new/revised Ind ASs in the context of the amendments made in IFRSs.

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Background

Due to development of cross-border capital markets, it is imperative that the financial statements in various countries follow a single, high quality accounting standards that are accepted globally. Keeping this in view, many developed and emerging economies have adopted or converged

The 35 Ind ASs placed on the MCA's website were based on the IFRSs issued as on 1st April, 2011. Subsequently, not only significant amendments have been made in IFRSs, but new IFRS have been issued. Keeping this in view, Ind ASs are being revised by the ICAI in the context of the amendments made in IFRSs and the carve-outs made earlier in the 35 Ind ASs have been examined again for their possible removal.

with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB). Till now, more than 100 countries require or permit use of IFRS. India, being an important emerging economy in the world, cannot remain isolated in this scenario. Thus in 2007, the Institute of Chartered Accountants of India (ICAI) initiated the process of moving towards IFRSs. This move was supported by the Ministry of Corporate Affairs (MCA), Government of India and, accordingly, after following the due process, 35 Indian Accounting Standards (Ind AS) converged with IFRSs were placed on the website of the MCA. However, the date of notification of the Ind ASs was not announced due to certain issues including tax issues.

India has followed the policy of convergence with International Financial Reporting Standards (IFRSs) instead of adopting the same. The ICAI examines and considers the IFRSs while formulating the Indian Accounting Standards (Ind ASs) and departures are made there from, wherever required, keeping in view the legal, regulatory and economic environment in India. These departures from the IFRSs are called carve-outs. In case some additional requirements which are considered necessary in the local environment are added, these are called carve-ins.

The ICAI while carrying out the process of convergence with IFRSs has always attempted to keep the carve-outs to the minimum and these are also taken forward and discussed with the IASB from time to time. The carve-outs are considered from the perspective of local environment and benefit to stakeholders including industry and are not rigid/permanent in nature. These are expected to be eliminated over a period of time either through issuance of amendments in IFRSs or by adoption of IFRS treatment in Ind ASs when the Indian environment becomes conducive to such removal in future.

Recent Developments in Carve outs/ins in Indian Accounting Standards

Consideration of the carve outs/ins in Ind ASs

The 35 Ind ASs placed on the MCA's website were based on the IFRSs issued as on 1st April, 2011. Subsequently, not only significant amendments have been made in IFRSs, but new IFRS have been issued. Keeping this in view, Ind ASs are being revised by the ICAI in the context of the amendments made in IFRSs and the carve-outs made earlier in the 35 Ind ASs have been examined again for their possible removal and it has also been considered whether any new carve-outs or carve-ins are required. These are being incorporated in the new/revised Ind AS after following the due process.

- **Major carve outs proposed to be removed**

The following carve outs relating to 35 Ind ASs placed on MCA's website are proposed to be removed as these have been addressed by the IASB:

Revenue recognition from real estate sale agreement

On the basis of principles of IAS 18, Revenue, IFRIC 15, Agreement for the Construction of Real Estate, prescribes that construction of real estate should be treated as sale of goods and revenue should be recognised when the entity has transferred significant risks and rewards of ownership and has retained neither continuing managerial involvement nor effective control. Practically, IFRIC 15 requires the real estate developers to recognise the revenue in their financial statements based on the completion method, *i.e.,* only in the last year of the completion of the project. It was felt that the profit and loss account of the developers will not truly reflect the performance of the business, as during the years the real estate project continues, no revenue will be recognised. This was not in accordance with the existing accounting practices prevailing in the country. Accordingly, such agreements were scoped out from Ind AS 18 and were included in Ind AS 11, Construction Contracts. This issue was taken up with the IASB by India and some other countries and IASB has issued IFRS 15, Revenue from Contracts with

Customers in May 2014 which addresses the concerns arising from IFRIC 15. Thus, the issuance of Ind AS 115 corresponding to IFRS 15 is expected to address the concerns arising from IFRIC 15 as it will supersede Ind ASs 11 and 18.

Accounting for Bearer Plants

IAS 41, Agriculture, required measurement of biological assets, *viz.*, living animals and plants at fair value and recognising gains and losses arising on such measurement in profit or loss, unless ascertainment of fair value is unreliable. Indian Accounting Standard corresponding to IAS 41 was not formulated in 2011, as it was felt by certain stakeholders that it was not suitable to the Indian conditions because it was based on determining fair values of various agricultural assets such as orchards, plantations and other such assets, which is not an appropriate method of accounting. Since, other countries, such as Malaysia, also had similar concerns, the Asia-Oceanic Standards-Setters Group (AOSSG) constituted a Working Group under the Chairmanship of India, with Malaysia as co-chair, to suggest limited scope amendments to IAS 41 for consideration of IASB. The ICAI was of the view that Bearer Biological Assets (flora) should be accounted for in accordance with Ind AS 16, Property plant and Equipment and fauna (animals) should continue to be valued at fair value as per IAS 41. The AOSSG submitted the ICAI's view as an alternative view to the IASB. The IASB has now addressed the concerns by recently issuing amendments to Agriculture: Bearer Plants (Amendments to IAS 16 and IAS 41) which are in line with the views of the ICAI. Accordingly, the Ind AS 41 and consequential amendments to Ind AS 16 are being finalised for issuance.

Gains on Own Credit Deterioration

At the time Ind AS 39 was finalised in 2011, IAS 39 required that all changes in fair value in case of financial liabilities designated at fair value through profit and loss at initial recognition shall be recognised in profit or loss. This was considered inappropriate for changes in own credit risk since a deterioration of in the entity's credit worthiness would have resulted in recognition of a gain in profit or loss. A *proviso* was, accordingly, added to paragraph 48 of Ind AS 39, Financial Instruments: Recognition and Measurement, that in determining the fair value of the financial liabilities which upon initial recognition are designated at fair value through profit or loss, any change in fair value consequent to changes in the entity's own credit risk shall be ignored. Indian Accounting Standard corresponding to IFRS 9 was not issued earlier since it was felt that it was incomplete. The IASB has recently issued IFRS 9, Financial Instruments, which will replace IAS 39. IFRS 9 requires the changes in fair values in case of financial liabilities due to changes in own credit risk to be recognised in other comprehensive income. Thus, the carve-out in Ind AS 39 will get removed after the issuance of Ind AS 109 corresponding to IFRS 9, as it will replace Ind AS 39.

The following carve-outs relating to 35 Ind ASs placed on MCA's website are proposed to be removed on reconsideration by the ICAI itself:

Accounting for Associates

IAS 28, Investment in Associates, requires that difference between the reporting period of an associate and that of the investor should not be more than three months, in any case. The phrase 'unless it is impracticable' was added in the relevant requirement in Ind AS 28. On reconsideration, it is felt that in case of impracticability to obtain financial statements prepared as on the date on which the financial statements of the investor are drawn (except the time gap permitted by the standard), it may be considered that the investor may not have significant influence over the investee. In other words, in such a case, it may be difficult to establish that the investor is having significant

Some carve-outs relating to 35 Ind ASs placed on MCA's website are proposed to be removed as these have been addressed by the IASB. These are: *'Revenue recognition from real estate sale agreement,' 'Accounting for Bearer Plants,' 'Gains on Own Credit Deterioration,' 'Accounting for Associates,' 'Investments in Associates through Mutual Funds, etc,' 'Forex gains/losses on Long-term Monetary Items,' and 'Comparatives in First Ind AS Financial Statements.'*

influence over the investee and, therefore, investee may not be regarded as an associate of the investor. Accordingly, the term 'unless impracticable' is proposed to be deleted from the aforesaid requirement of Ind AS 28.

Investments in Associates through Mutual Funds, etc.

In paragraphs 18 and 19 of Ind AS 28, Investment in Associates, corresponding to IAS 28, references to mutual funds, unit trusts and similar entities including investment linked insurance funds, were deleted as it was felt that the Companies Act, 1956, was not applicable to mutual funds, unit trusts and similar entities including investment linked insurance funds and, thus, this standard would not be applicable to such entities. However, on reconsideration it is felt that the deletion may give an indication that this Standard would be applicable to associates if investor holds investments through mutual funds and trusts since there are no specific exemptions. Accordingly, to avoid such interpretations, the reference to mutual funds, unit trust, *etc.*, has been restored in paragraphs 18 and 19 of Ind AS 28.

Forex Gains/Losses on Long-term Monetary Items

IAS 21, The Effects of Changes in Foreign Exchange Rates, requires recognition of exchange differences arising on translation of monetary items from foreign currency to functional currency directly in profit or loss. Ind AS 21 permitted an option to recognise exchange differences arising on translation of certain long-term monetary items from foreign currency to functional currency directly in equity. In this situation, Ind AS 21 also requires the accumulated exchange differences to be amortised to profit or loss in an appropriate manner which is given in paragraph 29A. It has been noted that as per IFRS 9, only those exposures can qualify for hedge accounting which have impact on the statement of profit and loss. Where an entity follows the option as stated above, such an entity would not be able to use hedge accounting as per IFRS 9. It is felt that, in any case, the option given in Ind AS 21 is conceptually inappropriate as the entity is able to defer the gains/losses arising from foreign exchange risks. Therefore, paragraph 29A of Ind AS 21 is proposed to be removed as the impact is not on profit or loss.

Major carve-outs which are still continuing include 'Foreign currency Convertible Bonds: Exception in the definition *'Financial Liability'* and *'Carrying Values of PPEs etc. may be used in First Ind AS Financial Statements.'* The new carve outs proposed to be included are: *'Current/Non-current Classification in case of breach of loan covenants,'* and *'Straight-lining of lease rentals in operating leases.'*

Comparatives in First Ind AS Financial Statements

IFRS 1 defines transitional date as beginning of the earliest period for which an entity presents full comparative information under IFRS. It is this date which is the starting point for IFRS and it is on this date the cumulative impact of transition is recorded based on assessment of conditions at that date by applying the standards retrospectively except to the extent specifically provided in this standard as optional exemptions and mandatory exceptions. Accordingly, the comparatives, *i.e.*, the previous year figures are also presented in the first financial statements prepared under IFRS on the basis of IFRS. The existing Ind AS 101 requires an entity to provide comparatives as per the existing notified Accounting Standards and not as per IFRS. Ind AS 101 further provides that, in addition to aforesaid comparatives, an entity may also provide comparatives as per Ind AS on a memorandum basis. This difference is proposed to be removed in the revised Ind AS 101, by requiring an entity to mandatorily provide comparatives as per Ind AS.

- **Major carve-outs still continuing**

Foreign currency Convertible Bonds: Exception in the definition 'Financial Liability'

An exception was included to the definition of 'financial liability' in paragraph 11 (b) (ii) of Ind AS 32, Financial Instruments: Presentation to consider the equity conversion option embedded in a convertible bond denominated in foreign currency to acquire a fixed number of entity's own equity instruments as an equity

instrument if the exercise price is fixed in any currency. This exception is not provided in IAS 32. The carve-out is considered appropriate for FCCBs since the number of shares convertible on the exercise of the option remains fixed and the amount at which the option is to be exercised in terms of foreign currency is also fixed; merely the difference in the currency should not affect the nature of derivative, *i.e.*, the option. This issue is under discussion with the IASB and will also be taken up at the next meeting of the Emerging Economies Group (EEG) scheduled to be held in December 2014.

Carrying Values of PPEs etc. may be used in First Ind AS Financial Statements

Ind AS 101 provides an entity an option to use carrying values of Property, Plant and Equipments, Intangible and Investment Property as on the date of transition in accordance with previous GAAP as an acceptable starting point under Ind AS. This carve out is being retained in Revised Ind AS 101 as the existing Indian notified Accounting Standards are not significantly different from IFRS as all the standards have been based on IFRS. It will minimise the cost of convergence

- **New Carve-outs proposed to be included**

Current/Non-current Classification in case of breach of loan covenants

Paragraph 74 of Ind AS 1, Presentation of Financial Statements, is proposed to be modified to clarify that the provision to reclassify a non-current liability as current would be applicable only for material breaches and that in case a breach is rectified after the balance sheet date but before the approval of financial statements for issue, it would be considered an adjusting event for the purpose of Ind AS 10. This carve-out is being proposed in view of the existing practices in India with regard to recalling the loans by banks. This issue is being taken up with the IASB.

Convergence is an ongoing process. Going forward, keeping in view further developments in the issuance of new/revised IFRS, the carve-outs would be closely monitored and discussed with IASB. The objective is to place the Indian Accounting Standards at par with IFRS so that the Indian corporates and the accounting professional reap the benefits of global accounting standard.

Straight-lining of lease rentals in operating leases

Paragraphs 33 and 50 of Ind AS 17, Leases, are proposed to be modified to provide that where the escalation of lease rentals is in line with the expected general inflation so as to compensate the lessor for expected inflationary cost, the increases in the rentals in case of operating leases shall not be straight-lined. This carve-out is being proposed in view of the current practice in India to include provisions for increase in rentals based on inflation in the lease agreements. This treatment is similar to that prescribed in IFRS for SMEs. This carve-out is expected to be temporary as the IASB would be issuing the new standard on Leases wherein the issue is expected to get addressed.

Conclusion

Convergence is an ongoing process. Going forward, keeping in view further developments in the issuance of new/revised IFRS, the carve-outs would be closely monitored and discussed with IASB. The objective is to place the Indian Accounting Standards at par with IFRS so that the Indian corporates and the accounting professional reap the benefits of global accounting standard. ■