

Amendments to Indian Accounting Standards (Ind AS) issued in July 2020

Ministry of Corporate Affairs (MCA) has issued the Companies (Indian Accounting Standards) Amendment Rules, 2020 dated 24 July 2020. The rules are effective from the date of publication in the Official Gazette of India i.e. 24 July 2020.

All amendments are effective for periods beginning 1 April 2020 or later. However, amendments relating to Ind AS 116, *Leases*, can be applied for financial year beginning 1 April 2019 or later if the financial statements for that period have not yet been authorised for issue. Accordingly, the amendments apply to the financial results for the quarter ended 30 June 2020, where such financial results have not yet been declared.

The amendments are mostly in line with the expected Ind AS amendments that I had indicated in my earlier post of 19 June 2020 (<https://joy-consulting.in/2020/06/19/expected-amendments-to-indian-accounting-standards-ind-as-in-2020/>).

Amendments to Ind AS are as follows:

Ind AS 103, *Business Combinations* (Ind AS 103)

The definition of “business” and related guidance included in the standard for the purposes of identifying where an acquisition is a business, to apply business combination accounting, has been amended.

Previous definition of business included in Ind AS 103 is as follows:

“An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants”.

The **amended definition** of business is as follows:

“An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing goods or services to customers, generating investment income (such as dividends or interest) or generate other income from ordinary activities”.

Key change is that the definition of business is narrowed to focus on providing goods or services to customers, generating investment income or generate other income from ordinary activities instead of the earlier wider focus of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.

Earlier the standard also provided that a business need not include all of the inputs and processes that the seller used in operating that business if market participants are capable of acquiring the business and continuing to produce outputs, for example, by integrating the business with their own inputs and processes. This requirement is now deleted.

Instead, the amended guidance requires that to be considered a business, an integrated set of activities and assets, must include at a minimum, an input and a substantive process that together contribute to the ability to create output. Additional guidance has been provided to assess whether a process is substantive or not.

The integrated set of activities and assets shall be capable of being conducted and managed as a business by a market participant. How the seller was using or how the buyer intends to use is not relevant. Further, to be a business without outputs, there will now need to be an organised workforce for it to constitute a business.

The amended guidance provides that if an acquired set of activities and assets has outputs, continuation of revenue does not on its own indicate that both an input and a substantive process have been acquired. An acquired set of activities and assets that is not a business might have liabilities i.e. the presence of liabilities does not mean that the set of acquired activities and assets is a business.

The standard earlier provided that if a particular set of activities and assets included goodwill, then such set of activities and assets was presumed to be a business. This presumption has now been deleted.

The amendment also provides that an entity can apply a 'concentration test' that, if met, eliminates the need for further assessment. Under this optional test, where 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 amended standard provides detailed guidance in this respect.

Following steps are included in the concentration test:

- Gross assets to exclude cash & cash equivalents, deferred tax assets, and any goodwill resulting from deferred tax liabilities;
- Identify fair value of gross assets – fair value of purchase consideration + fair value of NCI + fair value of previous held interests – (cash & cash equivalents + deferred tax assets + any goodwill resulting from deferred tax liabilities)
- Identify assets (single identifiable assets or group of similar assets) and their fair values.
- If for accounting purposes, a group of assets is recognised and measured as a single identified asset, then such group is a single asset.
- If one tangible asset is attached to, and cannot be removed physically and used separately, from another tangible asset, then both assets to be treated as one.
- For identifying similar assets – nature of each single asset and risks associated with managing and creating outputs from assets, have to be considered. Guidance is also provided where assets cannot be similar e.g. tangible and intangible assets, different classes of tangible or intangible assets, financial and non-financial assets, financial assets of

different classes e.g. loans and equity investments, identifiable assets in the same class but where they have significantly different risk characteristics.

The changes to the definition of a business will likely result in more acquisitions being accounted for as asset acquisitions across all industries, particularly real estate, pharmaceutical, and oil and gas.

Ind AS 107, *Financial Instruments: Disclosures* (Ind AS 107)

Ind AS 107 has been amended to require disclosure of the nominal amount of hedging instruments to which the reliefs are applied, any significant assumptions or judgements made in applying the reliefs, and qualitative disclosures about how the entity is impacted by IBOR reform and is managing the transition process.

The disclosures are applicable to companies applying exceptions in respect of interest rate benchmark reforms as inserted in Ind AS 109, *Financial Instruments*.

Ind AS 109, *Financial Instruments* (Ind AS 109)

Hedge accounting requirements included in Ind AS 109 have been amended to provide limited relief to financial statement preparers from the effects of the forthcoming IBOR (Interbank Offered Rate, also called interest rate benchmark) reform.

The amendments provide as follows:

1. The amendments shall be applied to all hedging relationships directly affected by interest rate benchmark reform. Exceptions to hedge accounting are as specified in the amendments. Companies will have to continue to apply all other hedge accounting requirements to hedging relationships directly affected by interest rate benchmark reform.
- A hedging relationship is directly affected by interest rate benchmark reform only if the reform gives rise to uncertainties about:
 - the interest rate benchmark (contractually or non-contractually specified) designated as a hedged risk; and/ or
 - the timing or amount of interest rate benchmark-based cash flows of the hedged item or of the hedging instrument.
 - The amendments require an entity to assume that:
 - the interest rate on which the hedged cash flows are based does not change as a result of the reform. Hence, where the hedged cash flows may change as a result of IBOR reform (for example, where the future interest payments on a hedged forecast debt issuance might be SONIA + X% rather than GBP LIBOR + Y%), this will not cause the ‘highly probable’ test to be failed;

- the interest rate benchmark on which the hedged cash flows (contractually or non-contractually specified) are based is not altered as a result of the reform; and
- the interest rate benchmark on which the cash flows of the hedged item, hedging instrument or hedged risk are based is not altered by IBOR reform and hence the economic relationship and hedge effectiveness is not affected.
- Under the amendments, where only a risk component is hedged, the risk component only needs to be separately identifiable at initial hedge designation and not on an ongoing basis. In the context of a macro hedge, where an entity frequently resets a hedging relationship, the relief applies from when a hedged item was initially designated within that hedging relationship.
- A company shall cease to apply the exceptions above as follows :
 - When the uncertainty arising from interest rate benchmark reform is no longer present; In respect of 3(a) above, at the earlier of (a) above and when the hedging relationship that the hedged item is a part of is discontinued;
 - In respect of 3(b) above, (a) above and when the entire amount accumulated in the cash flow hedge reserve with respect that discontinued hedging relationship has been reclassified to profit and loss;
 - In respect of 3(c) above, (a) above and to a hedging instrument, when the uncertainty arising from interest rate benchmark reform is no longer present with respect to the timing and the amount of interest rate benchmark-based cash flows of the hedging instrument.
- The amendments can be applied retrospectively to all hedging relationships affected by the interest rate benchmark reform that existed at the beginning of the reporting period in which the entity first applies these amendments or to those which were designated thereafter, and to amount accumulated in the cash flow hedging reserve that existed at the beginning of the reporting period in which the entity first applies these amendments.

For details on IBOR reform and its business and accounting consequences please read my blog post at <https://joy-consulting.in/2020/06/15/ibor-reform-what-in-the-heavens-is-that/> or my LinkedIn post at <https://www.linkedin.com/feed/update/urn:li:activity:6678171533095108608/>.

Ind AS 116, Leases (Ind AS 116)

Ind AS 116 has been amended to provide limited relief to lessees in respect of rent concessions arising due to Covid-19 pandemic. No relief has been allowed to the lessors.

The amendments provide a practical expedient that lessees may elect to not treat any rent concessions, provided by lessors as a direct consequence of Covid-19 pandemic, as lease modifications. However, to be eligible for this relief,

- a. the revised consideration for the lease should be less than or equal to the lease consideration immediately before the change,
- the rent concession should be for a period that does not extend beyond 30 June 2021 (for example, lease rents are reduced for a period upto 30 June 2021 and increased for periods thereafter), and
- there is no substantial modification to the other terms and conditions of the lease.

This means that such rent concessions can be taken by the lessees directly to the statement of profit and loss. However, the lessees will have to continue to account for interest expense and depreciation on right-of-use assets as before.

Lessees are required to apply this practically expedient retrospectively, recognising the cumulative effect of initially applying the amendment as an adjustment to the opening balance of retained earnings. However, in the Indian context, since the impact of Covid-19 was felt on business only in the later part of March 2020, the cumulative impact may not be significant.

Lessees are also required to provide disclosures about application of the practical expedient and its impact on profit or loss.

Ind AS 1, *Presentation of Financial Statements (Ind AS 1)* and Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors (Ind AS 8)*

The definition of “materiality” and related guidance has been amended in Ind AS 1.

Previous definition of materiality included in Ind AS 1 and Ind AS 8 is as follows:

“Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor”.

The **amended definition** of materiality is as follows:

“Information is material if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity”.

The amendments clarify that the information is obscured if it is communicated in a way that would have a similar effect for primary users of financial statements to omitting or misstating that information. The amendments provide examples of circumstances when a material information is obscured as follows:

- information regarding a material item, transaction or other event is disclosed in the financial statements but the language used is vague or unclear;

- information regarding a material item, transaction or other event is scattered throughout the financial statements;
- dissimilar items, transactions or other events are inappropriately aggregated;
- similar items, transactions or other events are inappropriately disaggregated; and
- the understandability of the financial statements is reduced as a result of material information being hidden by immaterial information to the extent that a primary user is unable to determine what information is material.

The amendments state that an entity is required to consider the characteristics of the users of its financial statements and also its own circumstances while determining what information can reasonably be expected to influence decisions made by the primary users of financial statements.

The amendments also clarify the meaning of ‘primary users of general purpose financial statements’ to whom those financial statements are directed, by defining them as ‘**existing and potential investors, lenders and other creditors**’ that must rely on general purpose financial statements for much of the financial information they need, and that, at times even well-informed and diligent users may need to seek the aid of an adviser to understand information about complex economic phenomena.

Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors* (Ind AS 8)

The existing amendment of materiality has been deleted from Ind AS 8. Instead, now a reference has been made to the amended definition of materiality in Ind AS 1.

Ind AS 10, *Events after the Reporting Period* (Ind AS 10)

Only consequential amendment made based on amendments in the definition of materiality in Ind AS 1.

Ind AS 34, *Interim Financial Reporting* (Ind AS 34)

Only consequential amendment made based on amendments in the definition of materiality in Ind AS 1.

Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets* (Ind AS 37) Only consequential amendment made to the requirement for disclosure of a restructuring announced or implemented after the reporting period, based on amendments in the definition of materiality in Ind AS 1.