Ind AS amendments including accounting for rent concessions and interest rate benchmark reforms

7 August 2020

First Notes on

Financial reporting

Corporate law updates

Regulatory and other information

Disclosures

Sector

All

Banking and insurance

Information, communication, entertainment

Consumer and industrial markets

Infrastructure and government

Relevant to

All

Audit committee

CFO

Others

Transition

Immediately

Within the next three months

Post three months but within six months

Post six months

Forthcoming requirement

Introduction

Indian Accounting Standards (Ind AS) are largely converged with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB). In the recent past, IASB along with IFRS Interpretations Committee (IFRIC) has issued various amendments to IFRS as part of annual improvement process or as specific amendments.

In line with the amendments made to IFRS, on 24 July 2020, the Ministry of Corporate Affairs (MCA) has issued amendments to certain Ind AS as summarised below.

Standard	Summary of amendments
Ind AS 1, *Presentation of Financial Statements* and Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*	• Refined definition of term 'material' and related clarifications. • Consequential amendments to other standards basis refined definition of material.
Ind AS 103, *Business Combinations*	• Revised definition of a 'business'. • Introduction of an optional concentration test to permit a simplified assessment of whether an acquired set of activities and assets is not a business. • Additional guidance on how to assess whether an acquired process is *substantive,* if the acquired set of activities and assets does not have outputs and if it does have outputs.
Ind AS 107, *Financial Instruments: Disclosures*	• Additional disclosures pertaining to interest rate benchmark reforms.
Ind AS 109, *Financial Instruments*	• Modification to some specific hedge accounting requirements to provide relief to the potential effects of uncertainty caused by the interest rate benchmark (IBOR) reform.
Ind AS 116, *Leases*	• Practical expedient which permits lessees not to account for COVID-19 related rent concessions as a lease modification.

(Source: KPMG in India's analysis, 2020 basis amendments to Ind AS made by MCA)

Overview of the amendments

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

- **Refined definition of term ‘material’:** Currently, Ind AS 1 defines the term ‘material’ 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.’

  Amendment

  The amendments refined the definition of material to be included in Ind AS 1 and Ind AS 8 which is as follows:

  ‘Information is material if omitting, misstating or ***obscuring*** *it* ***could reasonably be expected to*** *influence 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.’*

  (*Emphasis added*)

- **Application of refined definition:** Basis the revised definition of material, the amendments further clarifies the following:

  – *Impact on financial statements:* Materiality depends on the nature or magnitude of information, or both. An entity needs to assess whether information, either individually or in combination with other information, is material in the context of its financial statements taken as a whole.

  – *Obscure information:* An information is considered to be 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 provided examples of circumstances that may result in information being obscured. Those, *inter alia*, include:

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

    b. Information regarding a material item, transaction or other event is scattered throughout the financial statements and

    c. Similar items, transactions or other events are inappropriately disaggregated.

Effective date: An entity should apply the amendments prospectively for annual periods beginning on or after 1 April 2020.

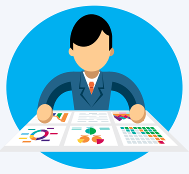
Other consequential amendments

Amendments have been made to the following standards consequent to the refined definition of material:

Standard	Description
Ind AS 10, *Events after the Reporting Period*	• Modifications in paragraph relating to non-adjusting events after the reporting period (Paragraph 21)
Ind AS 34, *Interim Financial Reporting*	• Reference of definition of material as given in Ind AS 1 and Ind AS 8 has been removed from the paragraph on materiality (Paragraph 24)
Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets*	• Modifications in paragraph relating to restructuring plan after the reporting period (Paragraph 75).

(Source: KPMG in India’s analysis, 2020 basis amendments to Ind AS made by MCA)

Effective date: An entity should apply these amendments when it applies amendments to the definition of material under Ind AS 1 and Ind AS 8.



Sectors likely to be impacted

The amendment is expected to affect entities operating in almost all sectors.

Overview of the amendments (cont.)

Ind AS 103, *Business Combinations*

- **Revised definition of a 'business':** Currently, Ind AS 103 defines business as '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'.**

  Amendment

  The amendments introduced a revised definition of a business for the purpose of identifying a business combination under Ind AS 103. As per the revised definition, business is '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 generating other income from ordinary activities'.**

  Related amendment has been made to the definition of 'output' as an element of business.

  (Emphasis added to highlight the change)

- **Elements of a business:** The three elements of a business as defined under Ind AS 103 include, inputs, processes applied to those inputs and outputs. Although businesses usually have outputs, outputs are not essential for an integrated set of activities and assets to qualify as a business.

  In order to be considered as a business, the amendments have clarified that an integrated set of activities and assets must include, at a minimum, an input and a *substantive process* that together significantly contribute to the ability to create output. Further, 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.

- **Optional concentration test:** The amendments include an election to use a 'concentration test'. This is a simplified assessment that would result in an acquisition to qualify as an asset acquisition. The concentration test is met if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or a group of similar identifiable assets.

  An entity may elect to apply, or not to apply, the concentration test. Such an election can be made separately for each transaction or other event.

  If the concentration test is not met or if the entity elects not to apply the test, then it assesses whether the set of assets and activities meet the definition of a business, such that it consists of an input and a substantive process that together significantly contribute to the ability to create outputs.

- **Assessment of a substantive acquired process:** The amendments prescribe how to assess whether an acquired process is substantive in the following situations:

  – *A set of activities and assets do not have outputs at the acquisition date:* An example of an acquired set of activities and assets that do not have outputs at the acquisition date is an early-stage entity that has not started generating revenues. Accordingly, in such cases, an acquired process or a group of processes would be considered substantive only if both the given criteria are met:

    a. It is critical to the ability to develop or convert an acquired input(s) into outputs and

    b. The inputs acquired include both an organised workforce that has the necessary skills, knowledge, or experience to perform that process (or group of processes) and other inputs that the organised workforce could develop or convert into outputs. Those other inputs could include:

       i. Intellectual property that could be used to develop a good or service

       ii. Other economic resources that could be developed to create outputs or

       iii. Rights to obtain access to necessary materials or rights that enable the creation of future outputs.

    Some of the examples of the above-mentioned inputs could be technology, in-process research and development projects, real estate and mineral interests.

  – *A set of activities and assets have outputs at the acquisition date:* An acquired set of activities and assets would be considered to have outputs at the acquisition date, if it was generating revenue at that date, irrespective of the fact that subsequently it will no longer generate revenue from external customers as it will be integrated by the acquirer. Accordingly, in such cases, an acquired process or a group of processes would be considered

Overview of the amendments (cont.)

Ind AS 103 (cont.)

substantive only if, when applied to an acquired input or inputs, it:

a. Is critical to the ability to continue producing outputs, and the inputs acquired include an organised workforce with the necessary skills, knowledge, or experience to perform that process (or group of processes) or

b. Significantly contributes to the ability to continue producing outputs and:

   i. Is considered unique or scarce or

   ii. Cannot be replaced without significant cost, effort or delay in the ability to continue producing outputs.

Effective date: An entity is required to apply the amendments to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after the 1 April 2020 and to asset acquisitions that occur on or after the beginning of that period.

Sectors likely to be impacted

The amendments are expected to affect entities operating in real estate sector, biotechnology sector, pharmaceutical sector and those operating in extraction activities.

Ind AS 109, *Financial Instruments*

In line with the amendments issued to IFRS vis-à-vis interest rate benchmark reforms (IBOR reform), following amendments have been made to Ind AS 109 modifying certain specific hedge accounting requirements:

- **Applicability:** The temporary exceptions would be applicable to all 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:

  a. The interest rate benchmark (contractually or non-contractually specified) designated as a hedged risk and/or

  b. The timing or the amount of interest rate benchmark-based cash flows of the hedged item or of the hedging instrument.

- **The highly probable requirement:** For a forecasted transaction to qualify as an eligible hedged item in a cash flow hedge, it must be 'highly probable'.

  Amendment

  The amendments require an entity to assume that the interest rate benchmark on which the hedged cash flows (contractually or non-contractually specified) are based is not altered as a result of interest rate benchmark reform.

  For discontinued hedging relationships also, the above assumption is applied while determining whether the hedged future cash flows are expected to occur.

- **Discontinued hedging relationships:** In case of a discontinued cash flow hedge (for any reason), Ind AS 109 specifies that when the amounts accumulated in the cash flow hedge reserve (in OCI) would be reclassified to profit or loss:

  a. Any amount remaining in the cash flow hedge reserve would be reclassified to profit or loss in the same period or periods during which the hedged cash flows affect profit or loss, assuming that interest rate benchmark on which the hedged cash flows are based is not altered as a result of interest rate benchmark reform.

  b. Where the hedged future cash flows are no longer expected to occur, the amount is immediately reclassified to profit or loss.

  Amendment

  In order to determine whether the hedged future cash flows are expected to occur, an entity should assume that the interest rate benchmark on which the hedged cash flows (contractually or non-contractually specified) are based is not altered as a result of interest rate benchmark reform.

Overview of the amendments (cont.)

Ind AS 109 (cont.)

- **Prospective assessments:** The condition of existence of an economic relationship (as per Ind AS 109) or that the hedge is highly effective (as per Ind AS 39, *Financial Instruments: Recognition and Measurement*) collectively referred to as 'prospective assessment'.

  Amendment

  The amendments require an entity to assess whether the economic relationship between the hedged item and the hedging instrument exists based on the assumptions that the interest rate benchmark on which the hedged item and the hedging instrument are based is not altered as a result of IBOR reform.

- **Eligibility of certain risk components (for a hedge of a non-contractually specified benchmark component of interest rate risk):** To be eligible for designation as a hedged item, a risk component[1] needs to be separately identifiable and the changes in the cash flows or fair value of the item attributable to changes in that risk component should be reliably measured.

  Amendment

  The amendment requires entities with hedges affected by the IBOR reform to apply the separately identifiable requirement only at the inception of the hedging relationship. A similar exception is also provided for redesignation of hedged items in hedges where dedesignation and redesignation take place frequently.

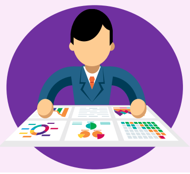
  A hedged item that has been assessed at the time of its initial designation in the hedging relationship, whether it was at the time of the hedge inception or subsequently, is not reassessed at any subsequent redesignation in the same hedging relationship.

- **End of application:** An entity should prospectively cease applying the exceptions at the earlier of:

  a. When the uncertainty regarding the timing and the amount of interest rate benchmark based cash flows is no longer present and

  b. The discontinuation of the hedging relationship (or reclassification of all amounts from the cash flow hedge reserve).

Effective date: The amendments will be effective for annual reporting periods beginning on or after 1 April 2020.



Sectors likely to be impacted

The amendments are expected to affect entities with foreign currency exposures in the form of loans, borrowings and who have also adopted hedge accounting for such exposures.

Ind AS 107, *Financial Instruments: Disclosures*

- **Disclosures pertaining to interest rate benchmark reform:** The amendments introduced following disclosures to be made by an entity in respect of hedging relationships to which it applies the exceptions provided under Ind AS 109 (interest rate benchmark reform):

  a. Significant interest rate benchmarks to which the entity's hedging relationships are exposed

  b. Extent of the risk exposure the entity manages that is directly affected by the interest rate benchmark reform

  c. How the entity is managing the process to transition to alternative benchmark rates

  d. A description of significant assumptions or judgements the entity made (for example, assumptions or judgements about when the uncertainty arising from interest rate benchmark reform is no longer present with respect to the timing and the amount of the interest rate benchmark-based cash flows) and

  e. The nominal amount of the hedging instruments in those hedging relationships.

- **Exemption from disclosure under Ind AS 8:** When initial application of an Ind AS has an effect on the current period or any prior period, paragraph 28(f) of Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*

1. Risk component includes the changes in the cash flows or fair value of an item attributable to a specific risk or risks.

Overview of the amendments (cont.)

Ind AS 107 (cont.)

requires an entity to disclose, in respect of current period and each prior period presented, to the extent practicable, the amount of the adjustment:

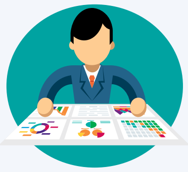
a. For each financial statement line item affected and

b. If Ind AS 33, *Earnings per Share*, applies to the entity, for basic and diluted earnings per share.

Amendment

As per the amendments, an entity is not required to present the quantitative information required by paragraph 28(f) of Ind AS 8, in the reporting period in which it first applies interest rate benchmark reform.

Effective date: An entity should apply these amendments when it applies the amendments to Ind AS 109.



Sectors likely to be impacted

The amendment is expected to affect entities with foreign currency exposures in the form of loans, borrowings and who have also adopted hedge accounting for such exposures.

Ind AS 116, *Leases*

Ind AS 116 defines a lease modification as a change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease. If a change in lease payments results from a lease modification, then unless the change meets particular criteria to be accounted for as a separate lease, a lessee is required to remeasure the lease liability by discounting the revised lease payments using a revised discount rate.

Amendment

Following amendments have been made with respect to accounting of COVID-19 related rent concessions such as rent holidays and temporary rent reductions:

- **Practical expedient:** The amendments permit lessees, as a practical expedient, not to assess whether rent concessions that occur as a direct consequence of COVID-19 pandemic and meet specified conditions are lease modifications and, instead, to account for those rent concessions as if they were not lease modifications.

  The amendment does not affect lessors. Lessors are required to continue to assess if the rent concessions are lease modifications and account for them accordingly.

- **Conditions to be complied:** The key conditions for applying the practical expedient are as follows:

Is rent concession a direct consequence of the COVID-19 pandemic?

↓ Yes

Is the revised consideration for the lease substantially the same as, or less than, the consideration for the lease immediately preceding the change?

↓ Yes

Does the rent concession affects only lease payments originally due on or before 30 June 2021?

↓ Yes

No substantive changes to the other terms and conditions of the lease?

↓ Yes

Practical expedient applicable

(Source: KPMG IFRG Limited's publication, Leases – Rent concessions, Responding to the COVID-19 pandemic, June 2020)

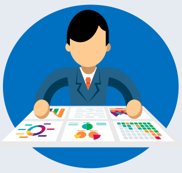
Overview of the amendments (cont.)

Ind AS 116 (cont.)

- **Disclosures:** Lessees applying the practical expedient are required to disclose:
  a. That fact, if they have applied the practical expedient to all eligible rent concessions and, if not, the nature of the contracts to which they have applied the practical expedient and
  b. The amount recognised in profit or loss for the reporting period to reflect changes in lease payments that arise from rent concessions to which the lessee has applied the practical expedient.
- **Exemption from disclosure under Ind AS 8:** The disclosure requirements of Paragraph 28(f) of Ind AS 8 do not apply on initial application of these amendments.

Effective date: A lessee should apply the amendments for annual reporting periods beginning on or after 1 April 2020. In case a lessee has not yet approved the financial statements for issue before the issuance of the amendments, then the same may be applied for annual reporting periods beginning on or after the 1 April 2019.

A lessee should apply the amendments retrospectively and recognises the cumulative effect of initially applying them in the opening retained earnings of the reporting period in which they are first applied.



Sectors likely to be impacted

The amendment is expected to affect entities with high amount of assets on leases and who have availed rent concessions amid the pandemic. For instance, consumer goods and retail sector, media and entertainment sector, manufacturing entities, hospitality sector, etc.

Our comments

The amendments are expected to provide much needed guidance on various important areas in particular those relating to interest rate benchmark reforms, accounting of rent concessions amid COVID-19 and determination of a business combination and an asset acquisition.

Some of the key considerations are as follows:

- **Refined definition of 'material':** The application of the concept of 'materiality' and application of materiality judgements have always been important in the preparation of financial statements. Along the lines of IFRS, the definition of material has been refined in Ind AS as well to make it easier to comprehend. However, identification of information which is obscure could pose challenge for entities. Accordingly, the amendments have incorporated certain examples of information being obscured to be considered by entities.
- **Clarification on what is a 'business':** Determination of whether a transaction results in an asset or a business acquisition has been a challenging area that requires application of significant judgement. The effect of amendments is that the new definition of a business is narrower – this would result in fewer business combinations being recognised.

  An optional concentration test has been introduced in Ind AS 103 which provides a simplified assessment which if met would result in an asset acquisition accounting.
- **Amendments pursuant to interest rate benchmark reforms:** The shift in the benchmark interest rates (such as Inter-Bank Offer Rates (IBORs)) with alternative, nearly risk-free interest rates (alternate interest rates) is expected to pose stability and liquidity risks for global markets and introduces financial risks and accounting challenges to all companies with IBOR exposures – banks and corporates alike. To address the impact, IASB undertook a project and identified following two groups of issues which have significant financial reporting implications:
  - **Pre-replacement issues:** Issues affecting financial reporting in the period before replacement of IBOR with an alternate interest rate, and
  - **Replacement issues:** Financial reporting issues arising once the IBOR had been replaced.

  In India, financial contracts with international counterparties such as foreign currency denominated borrowings, loans, trade credit, derivative contract that reference IBORs would be impacted by the reform. Additionally, the instruments linked to the Mumbai Interbank Forward Offer Rate (MIFOR), which is derived from USD LIBOR will also be affected.

Our comments (cont.)

Accordingly, the amendments to Ind AS 109 address the pre-replacement issues and the possible impact on hedge accounting requirements. It aims to modify some specific hedge accounting requirements to provide relief from potential effects of the uncertainty caused by the IBOR reform. These uncertainties could result in discontinuation of hedge accounting for hedging relationships that would otherwise qualify for hedge accounting or prevent entities from designating new hedging relationships.

It is to be noted that the exceptions envisaged through amendments are intended to address only the uncertainties arising from the IBOR reform. Accordingly, if a hedging relationship fails any of the other criteria, then the entity must discontinue hedge accounting as required by Ind AS 109 or Ind AS 39.

Additionally, the amendments to Ind AS 107 require companies to provide additional information to investors about their hedging relationships which are directly affected by these uncertainties.

Entities should start assessing the impact of the changes and accordingly, should develop systems and processes to cater to the possible challenges.

The IASB has already commenced discussion on the second phase of the project i.e. addressing the issues that might affect financial reporting when an existing interest rate benchmark is replaced with an alternative interest rate (replacement issues) and issued an exposure draft, *Interest Rate Benchmark Reform - Phase 2* in April 2020. It is expected to issue final amendments in the third quarter of 2020. Entities should keep a watch on the developments in this area.

- **Rent concessions amid COVID-19:** Under Ind AS 116, rent concessions often meet the definition of a lease modification. The accounting for lease modifications can be complex. For instance, the lessee may be required to calculate lease liabilities using a revised discount rate and adjust right-of-use assets. To address the challenge, in line with IASB, MCA has issued amendment to Ind AS 116 and introduces a practical expedient for lessees which allows a lessee not to account rent concessions as a direct consequence of COVID-19 as lease modifications. Instead it would be accounted under other applicable guidance. For instance, if the rent concession was in the form of a one-off reduction in rent, then it would be accounted for as a variable lease payment and be recognised in profit or loss. However, no such relief has been provided to lessors.

The practical expedient has been made applicable from accounting periods beginning on or after 1 April 2020. A lessee is permitted to apply the practical expedient from annual reporting period beginning on or after 1 April 2019, if the financial statements were not approved for issue as at 24 July 2020 (i.e. date of issue of amendments to Ind AS 116).

Determination of eligibility of the rent concession for practical expedient would require an entity to exercise judgement including consideration of its terms and an analysis of the original terms of the contract to ensure that there are no other substantive changes that may make it ineligible.

Though the practical expedient is expected to provide relief to the lessees, it is also likely to result in increase in income statement volatility for lessees with large portfolio of leases. It might reduce the comparability of profits, Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA) and other key indicators which entities normally use for year-on-year performance analysis.

This might also necessitate changes in the entity's present systems and processes for accounting lease transactions. Entities should evaluate the costs of making the change against the potential benefits it is expected to receive by applying the practical expedient.

In addition to the existing disclosure requirements under Ind AS 116, lessees are required to provide disclosures relating to the application of the practical expedient. Entities should consider providing adequate disclosures for conveying better information to the investors and other stakeholders.

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Missed an issue of Accounting and Auditing Update or First Notes

Issue no. 48 – July 2020

The topics covered in this issue are:

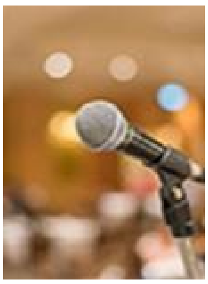
- Interim financial reporting in light of COVID-19
- Analysis of disclosures on COVID-19 by listed entities
- Accounting of CSR related expenses - Key considerations
- Regulatory updates

Guidance on subsequent events owing to COVID-19

17 June 2020

Due to coronavirus (COVID-19) pandemic and the uncertainty that it has unleashed, it has become more important than before that management and auditors of companies are vigilant to subsequent events and provide appropriate adjustment or disclosure for these events in order to enhance the quality of financial reporting.

Recently, the Institute of Chartered Accountants of India (ICAI) and the International Accounting and Auditing Standards Board (IAASB) have issued guidance on 'subsequent events' arising on account of COVID-19. The guidance specifies management considerations while assessing events occurring after the date of financial statements along with auditor's responsibilities. In this issue of First Notes, we cast our lens on the matters relevant for management while evaluating subsequent events arising as a result of the pandemic as highlighted in the guidance.



Voices on Reporting

KPMG in India is pleased to present Voices on Reporting (VOR) – a series of knowledge sharing calls to discuss current and emerging issues relating to financial reporting.

On 21 July 2020, KPMG in India released its VOR – quarterly updates publication for the quarter ended 30 June 2020. The publication provides a summary of key updates from the Securities and Exchange Board of India, the Ministry of Corporate Affairs, the Institute of Chartered Accountants of India and the Reserve Bank of India.

To access the publication, please click here.

Feedback/queries can be sent to aaupdate@kpmg.com

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