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Recent changes to Ind AS notified by the MCA that are effective for annual reporting periods beginning on or after April 1, 2023.

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Introduction:

Ministry of Corporate Affairs has notified the Companies (Indian Accounting Standards) Amendment Rules, 2023 on 31 March 2023, which are effective for annual reporting periods beginning from 1 April 2023. These changes are applicable and effective on all entities that report under the Ind AS accounting framework for accounting periods beginning on/after the above-mentioned date.

Though amendments have been made to a number of standards including Ind AS 101, Ind AS 102, Ind AS 103, Ind AS 107, Ind AS 109, Ind AS 115, Ind AS 34, substantive amendments relate only to the following:

Ind AS 1 – Presentation of Financial Statements

The amendment seeks to enhance communication in financial reporting. The changes aim to address how the effectiveness of disclosures in Ind AS financial statements can be improved. The standard now defines material accounting policy information which replaces significant accounting policy, and provides guidance on determining what is material accounting policy information.

Ind AS 8 – Accounting Policies, Changes in Accounting Estimates and Errors

The existing standard did not define accounting estimate, however the standard defines "change in accounting estimates". The amendments are aimed at bringing clarity to the definition of accounting estimate along with the distinction between changes in accounting estimates and changes in accounting policies and the correction of errors.

Ind AS 12 – Income Taxes

The standard has been amended to reduce diversity in the way entities were recognising deferred tax on transactions and events, such as leases and decommissioning obligations, that result in initial recognition of both an asset and a liability, which would result in recognition of deferred tax liability and deferred tax asset on gross basis on date of initial recognition. The amendment limits the scope of initial recognition exemption to exclude transactions that give rise to equal taxable and deductible temporary differences. The amendment also provides guidance in determining whether any temporary differences exists or not on initial recognition of the asset and liability.

Through this publication we share our analysis and views on the above-mentioned changes.

Amendment to Ind AS 1 – Presentation of Financial Statements

Ind AS 1 required disclosure of accounting policies. However, it did not define 'accounting policies' as such. The amendments are aimed at ensuring that entities now provide more relevant accounting policy disclosures:

- Entities are now required to disclose 'material' accounting policies in place of 'significant' accounting policies; and
- Providing guidance on how entities need to identify material accounting policy disclosures.

To address this, there are two significant themes addressed by the amendment:

A. Issue of boiler plate disclosures

The amendments to Ind AS 1, seek to address the issue of boiler plate disclosures as significant accounting policies wherein companies simply reproduced the requirements of the standard in brief. In fact, a company's significant accounting policy disclosure was the best reference material to understand summarily the requirements of a standard. However, such disclosure did not provide any information on how the company applies the requirements of the standard to its own circumstances. As per the existing practice, entities were disclosing standardised accounting policies that were replicating the requirement of the Ind AS. It was felt that such disclosures made the accounting policies less relevant to users and thus reduced the understandability of financial statements.

Further, reproduction of the requirements of a standard in summary form does not result in disclosure of material accounting policy.

The entities now need to balance between disclosure of accounting policy that are too descriptive or standardised with the disclosure of the accounting standards that describe the manner in which the accounting standards are applied for the transactions entered in by a company.

B. Replacing the term “significant” with material

Ind AS does not define the term “significant”, and hence it was decided to replace the term “significant” with “material” with respect to disclosure of accounting policy information. Further, it was a lingering question as to which policies could be considered as significant.

As the term “material” is defined and well understood by all stakeholders, it was decided to change from significant accounting policy to material accounting policy. On change to material accounting policy, the same question arose as to what material accounting policies are and whether the materiality of a transaction, event or conditions necessarily makes the accounting policy also material to be disclosed.

In the amendment, material accounting policy is defined in paragraph 117 of Ind AS 1 as “An entity shall disclose material accounting policy information. Accounting policy information is material if, when considered together with other information included in an entity’s financial statements, it can reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements.”

Further, Ind AS also contain “insignificant” being used in number of places. Ind AS does not define “insignificant” too. An attempt to define “significant” could result in unforeseen consequences as the use of the same term could be with some other meaning in other places. Further, a definition of significant would mean that the term “insignificant” is also being defined. Therefore, it was decided not to define the term “significant” and change the term from “significant” to “material”.

As per the guidance given under paragraph 117A of Ind AS 1, materiality depends on the nature or magnitude of information, or both. An entity is required to assesses whether information, either individually or in combination with other information, is material in the context of its financial statements taken as a whole.

The amendment also provides that “accounting policy information is expected to be material if users of an entity’s financial statements would need it to understand other material information in the financial statements”. The standard now provides below illustrative scenarios under which accounting policy information will be considered material:

- the entity changed its accounting policy during the reporting period and this change resulted in a material change to the information in the financial statements;
- the entity chose the accounting policy from one or more options permitted by Ind ASs;
- the accounting policy was developed in accordance with Ind AS 8 in the absence of an Ind AS that specifically applies;

- the accounting policy relates to an area for which an entity is required to make significant judgements or assumptions in applying an accounting policy, and the entity discloses those judgements or assumptions in accordance with paragraphs 122 and 125 of Ind AS 1; or
- the accounting required for them is complex and users of the entity's financial statements would otherwise not understand those material transactions, other events or conditions— such a situation could arise if an entity applies more than one Ind AS to a class of material transactions.

Assessing whether information could reasonably be expected to influence decisions made by the primary users of entity's general purpose financial statements, the entity must take into account both the characteristics of its users and its own specific circumstances.

The amendment also provides that disclosure of immaterial accounting policy information may still be made, although not required. Where an entity discloses accounting policy information that is not material, it needs to ensure that immaterial information does not obscure material information.

To illustrate, an entity would need to cover the following aspects when preparing a disclosure of accounting policy for Property, plant and equipment as per Ind AS 16:

- An entity is not required to reproduce the requirements of Ind AS 16 in summary form;
- Any change in accounting policy and the change has a material effect;
- The company has opted for a policy choice permitted by the standard, e.g. measurement of property, plant and equipment using the cost model or revaluation model;
- The policy was developed based on the hierarchy specified in paragraphs 10 to 12 of Ind AS 8;
- The policy requires significant judgements or assumptions and the company discloses those judgements or assumption in accordance with paragraph 122 and 125 of Ind AS 1; or
- The company is required to apply more than one Ind AS to recognise and measure property, plant and equipment.

Amendment to Ind AS 8 – Accounting Policies, Changes in Accounting Estimates and Errors

Ind AS 8 defines accounting policies, however the existing Ind AS 8 did not define accounting estimates. The current guidance given in the standard made it difficult to clearly demarcate the difference between accounting policy and accounting estimates under many scenarios. It should be noted that changes to estimates are applied prospectively compared to changes in accounting policies which are applied retrospectively, and thus require a restatement.

The amendment defines accounting estimate as "monetary amounts in financial statements that are subject to measurement uncertainty".

The standard now provides examples of accounting estimates:

- "a loss allowance for expected credit losses, applying Ind AS 109, Financial Instruments;
- the net realisable value of an item of inventory, applying Ind AS 2, Inventories;
- the fair value of an asset or liability, applying Ind AS 113, Fair Value Measurement;
- the depreciation expense for an item of property, plant and equipment, applying Ind AS 16; and
- a provision for warranty obligations, applying Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets."

The amendment in the standard also clarifies the relationship between accounting estimates and accounting policy through guidance given in paragraph 32 of Ind AS 8:
"An accounting policy may require items in financial statements to be measured in a way that involves measurement uncertainty—that is, the accounting policy may require such items to be measured at monetary amounts that cannot be observed directly and must instead be estimated. In such a case, an entity develops an accounting estimate to achieve the objective set out by the accounting policy."

The guidance also provides that "Developing accounting estimates involves the use of judgements or assumptions based on the latest available, reliable information."

Another clarification inserted in the standard provides that the term 'estimate' has been used widely in Ind AS and all such references may not necessarily relate to accounting estimate as defined in Ind AS 8 now. In some cases, these estimates may refer to inputs in developing the accounting estimates. The amendments also clarify that measurement techniques and inputs are used to develop accounting estimates, and measurement techniques include estimation (for example, techniques used to measure a loss allowance for expected credit losses applying Ind AS 109) and valuation techniques (for example, techniques used to measure the fair value of an asset or liability applying Ind AS 113).

The effects of a change in an input or a measurement technique used to develop an accounting estimate are considered as changes in accounting estimates only where they do not result from the rectification of prior period errors.

Amendment to Ind AS 12 – Income Taxes

The existing standard contains exceptions from recognising the deferred tax effects of certain temporary differences arising on the initial recognition of some assets and liabilities. These exceptions are usually referred to as 'initial recognition exemption'.

A transaction, other than a business combination transaction, may lead to the initial recognition of an asset and a liability and at the same time doesn't affect either the accounting or the taxable profit at the time of initial recognition. "For example, at the commencement date of a lease, a lessee typically recognises a lease liability and the corresponding amount as part of the cost of a right-of-use asset. Depending on the applicable tax law, equal taxable and deductible temporary differences may arise on initial recognition of the asset and liability in such a transaction".

The amendment has been brought in response to divergence in practice in relation to application of the initial recognition exemption to transactions and events, such as leases, that lead to the recognition of an asset and a liability.

The amendments address this issue and limit the scope of the recognition exemption to exclude transactions that, upon initial recognition, generate equal taxable and deductible temporary differences.

The amendments clarify that where payments made against liability are deductible for tax purposes, the entity shall apply judgement based on the tax laws applicable to the entity to evaluate whether such deductions are attributable for tax purposes to the liability recognised in the financial statements or relate to the asset component recognised in the financial statements. This judgement is crucial in determining whether temporary differences exists on initial recognition of the asset and liability.

For example, in India, tax deductions in relation to right of use assets and lease liabilities are usually given when the costs are paid, and depreciation against Right of Use Asset is excluded when computing taxable profit. We would therefore normally conclude, for entities subject to Indian tax laws, that the tax deductions relate to the lease liability.

The newly inserted paragraph 22A of the standard clarifies that, depending on the applicable tax law, when equal taxable and deductible temporary differences arise on initial recognition of the asset and liability, the entity must recognise a separate deferred tax asset ("DTA") and deferred tax liability ("DTL"), provided both the DTA and DTL are equal. In other words, recognition should be on gross basis.

The standard allows an entity to recognise deferred tax assets only "to the extent that it is probable that taxable profit will be available against which the deductible temporary

difference can be utilised". As a result, in certain circumstances, equal taxable and deductible temporary differences might result in an entity recognising unequal amounts of deferred tax assets and liabilities. Such a scenario is envisaged by the standard, and in such cases, paragraph 22(b) of Ind AS 12 requires an entity to recognise any difference in profit or loss. For instance, in a scenario where an entity is unable to recognise a deferred tax asset that offsets the amount of deferred tax liability recognised on initial recognition, the resulting difference would be recognised as an income tax loss.

The intent behind this guidance is that such accounting appropriately reflects the entity's expectation that it will be unable to benefit fully from the tax deductions available when it settles the liability, but that it is required to make future tax payments as it recovers the asset. Such situations are expected to be rare, because the recoverability requirement may also be met through the future reversal of taxable temporary differences arising from the same transaction.

Transitional Provisions

The standard has inserted paragraphs 98J, 98K and 98L to provide the transitional provisions.

- Companies shall apply the amendments to transactions that occur on or after the beginning of the earliest comparative period presented.

- Companies applying the amendments shall also, at the beginning of the earliest comparative period presented:

  - ◊ recognise a deferred tax asset – to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised – and a deferred tax liability for all deductible and taxable temporary differences associated with:

    - » right-of-use assets and lease liabilities; and
    - » decommissioning, restoration and similar liabilities, and the corresponding amounts recognised as part of the cost of the related asset; and

  - ◊ recognise the cumulative effect of initial application in the opening balance of retained earnings at that date.

Illustrative Example

(based on the illustration issued by IFRS Foundation in relation to Amendment to IAS 12 - Deferred Tax related to Assets and Liabilities arising from a Single Transaction)

An entity (Lessee) enters into a five-year lease of a building. The annual lease payments are INR 1 Crores payable at the end of each year. Before the commencement date of the lease, Lessee makes a lease payment of INR 15 Lakhs (advance lease payment) and pays initial direct costs of INR 5 Lakhs. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate

is 5% per year. At the commencement date, applying Ind AS 116 Leases, Lessee recognises a lease liability of INR 4.35 Crores (measured at the present value of the five lease payments of INR 1 Crores, discounted at the interest rate of 5% per year). Lessee measures the right-of-use asset (lease asset) at INR 4.55 Crores, comprising the initial measurement of the lease liability (INR 4.35 Crores), the advance lease payment (INR 15 Lakhs) and the initial direct costs (INR 5 Lakhs).

The tax law allows tax deductions for lease payments (including those made before the commencement date) and initial direct costs when an entity makes those payments. Economic benefits that will flow to Lessee when it recovers the carrying amount of the lease asset will be taxable. A tax rate of 25% is expected to apply to the period(s) when Lessee will recover the carrying amount of the lease asset and will settle the lease liability. After considering the applicable tax law, Lessee concludes that the tax deductions it will receive for lease payments relate to the repayment of the lease liability.

Lessee recognises the advance lease payment (INR 15 Lakhs) and initial direct costs (INR 5 Lakhs) as components of the lease asset's cost. The tax base of these components is nil because Lessee already received tax deductions for the advance lease payment and initial direct costs when it made those payments. The difference between the tax base (nil) and the carrying amount of each component results in taxable temporary differences of INR 15 Lakhs (related to the advance lease payment) and INR 5 Lakhs (related to the initial direct costs).

Impact of the amendment to Ind AS 12:

The exemption from recognising a deferred tax liability does not apply because the temporary differences arise from transactions that, at the time of the transactions, affect Lessee's taxable profit (that is, the tax deductions Lessee received when it made the advance lease payment and paid initial direct costs reduced its taxable profit). Accordingly, Lessee recognises a deferred tax liability of INR 3.75 Lakhs (INR 15 × 25%) and INR 1.25 Lakhs (INR 5 × 25%) for the taxable temporary differences related to the advance lease payment and initial direct costs, respectively.

At the commencement date, the tax base of the lease liability is nil because Lessee will receive tax deductions equal to the carrying amount of the lease liability (INR 4.35 Crores). The tax base of the related component of the lease asset's cost is also nil because Lessee will receive no tax deductions from recovering the carrying amount of that component of the lease asset's cost (INR 4.35 Crores).

The differences between the carrying amounts of the lease liability and the related component of the lease asset's cost (INR 4.35 Crores) and their tax bases of nil result in the following temporary differences at the commencement date:

A. a taxable temporary difference of INR 4.35 Crores associated with the lease asset; and
B. a deductible temporary difference of INR 4.35 Crores associated with the lease liability.

The exemption from recognising a deferred tax asset and liability does

not apply because the transaction gives rise to equal taxable and deductible temporary differences. Lessee concludes that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised. Accordingly, Lessee recognises a deferred tax asset and a deferred tax liability, each of INR 1.08 Crores (INR 4.35 Crores × 25%), for the deductible and taxable temporary differences.

Applying paragraph 22(b) of Ind AS 12, Lessee recognises deferred tax assets and liabilities as illustrated in this example and recognises the resulting deferred tax income or expense in profit or loss.

Next Steps:

These are important changes brought in by the MCA and align Ind AS with the IFRS as issued by the IASB. We are of the view, that entities must assess implication of these changes so that relevant disclosures can be made in the financial statements for the year ended March 31, 2023, with respect to standards issued but not effective. Further, listed companies and their group entities need to determine the impact for their Q1 reporting.

1. Re-drafting the accounting policy

The replacement of "significant" with "material" accounting policy information under Ind AS 1 will impact the accounting policy disclosures. Identification of what is material requires greater use of judgement. Therefore, we recommend that entities review their accounting policy information disclosures to ensure consistency with the amended standard.

It has been observed that boilerplate disclosures are used for providing accounting policy information. While the conceptual framework assumes that the primary user of financial statements have a reasonable level of financial knowledge, the framework also acknowledges, that not all users of the financial statements are accounting experts. Entities should carefully consider whether "standardised information, or information that only duplicates or summarises the requirements of the Ind ASs" is material information and, if not, whether it should be removed from the accounting policies disclosures to enhance the usefulness of the financial statements.

The change in disclosure of accounting policies requires detailed evaluation by companies and may require judgement. Although the change to eliminate unnecessary disclosure is welcome, companies will need to be careful to ensure that useful accounting policy disclosure isn't excluded from financial statements.

2. Clearer demarcation between Accounting Policy and Accounting Estimate

The amendments are clarificatory in nature, and defining an accounting estimate has now made it easier to understand the demarcation between accounting policies and accounting estimate.

In our view, there is no significant impact on the financial statements of the company. The amendments will enable companies to make better judgement on whether a change is a change in accounting policy or change in accounting estimate or correction of prior period error.

The companies need to understand the interplay between accounting policy and accounting estimate here. Accounting policies may require items in financial statements to be measured in a way that involves measurement uncertainty, which means that accounting policy may require such items to be measured at monetary amounts that cannot be observed directly and instead require estimation. In these cases, entities are required to develop an accounting estimate to meet the requirement of the accounting policy. Companies are required to use judgement and assumptions to develop accounting estimates, which should always be based on latest available information.

3. Accounting, presentation and disclosure of Deferred Taxes

The proposed amendment are much needed as they address the existing diversity in practice which became more prevalent with the adoption of Ind AS 116 – Leases. These amendments will potentially impact entities that have significant balances of right of use assets, lease liabilities, decommissioning provision who have not recognised deferred taxes using the initial recognition exemption.

The companies need to understand the impact of these amendments and carry out an analysis almost immediately, considering that the impact of standards issued but not effective shall have to be made in the financial statements for the year ended March 31, 2023. Further, for entities listed in India, the impact of this change shall have to be recognised in the results released for the quarter ending June 2023.

Potential impact with respect to leasing arrangements: Usually in lease agreements, a lessee is required to make lease payments in advance and may also incur initial direct costs. Ind AS 116 requires such payments to be added to the cost of right-of-use asset. This would give rise to unequal amounts of taxable and deductible temporary differences. In such cases, if those lease payments affect taxable profit, the initial recognition exemption will not apply. The company shall recognise the resulting difference between deferred tax liability and deferred tax asset in profit or loss.

Potential impact on entities that were currently recognising Deferred taxes using a net approach: Where an entity has previously accounted for deferred tax on leases and decommissioning liabilities under the net approach, then the impact on transition is likely to be limited to the separate presentation of the deferred tax asset and the deferred tax liability.

However, where recoverability of deferred tax asset is not probable, an unequal amount of deferred tax asset and liability will be recognised, with the consequent impact routed through the profit or loss.

Companies impacted by this change should also discuss the impact of this change with their auditors as entities may be required to exercise judgement in determining recoverability of the deferred tax balances.

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