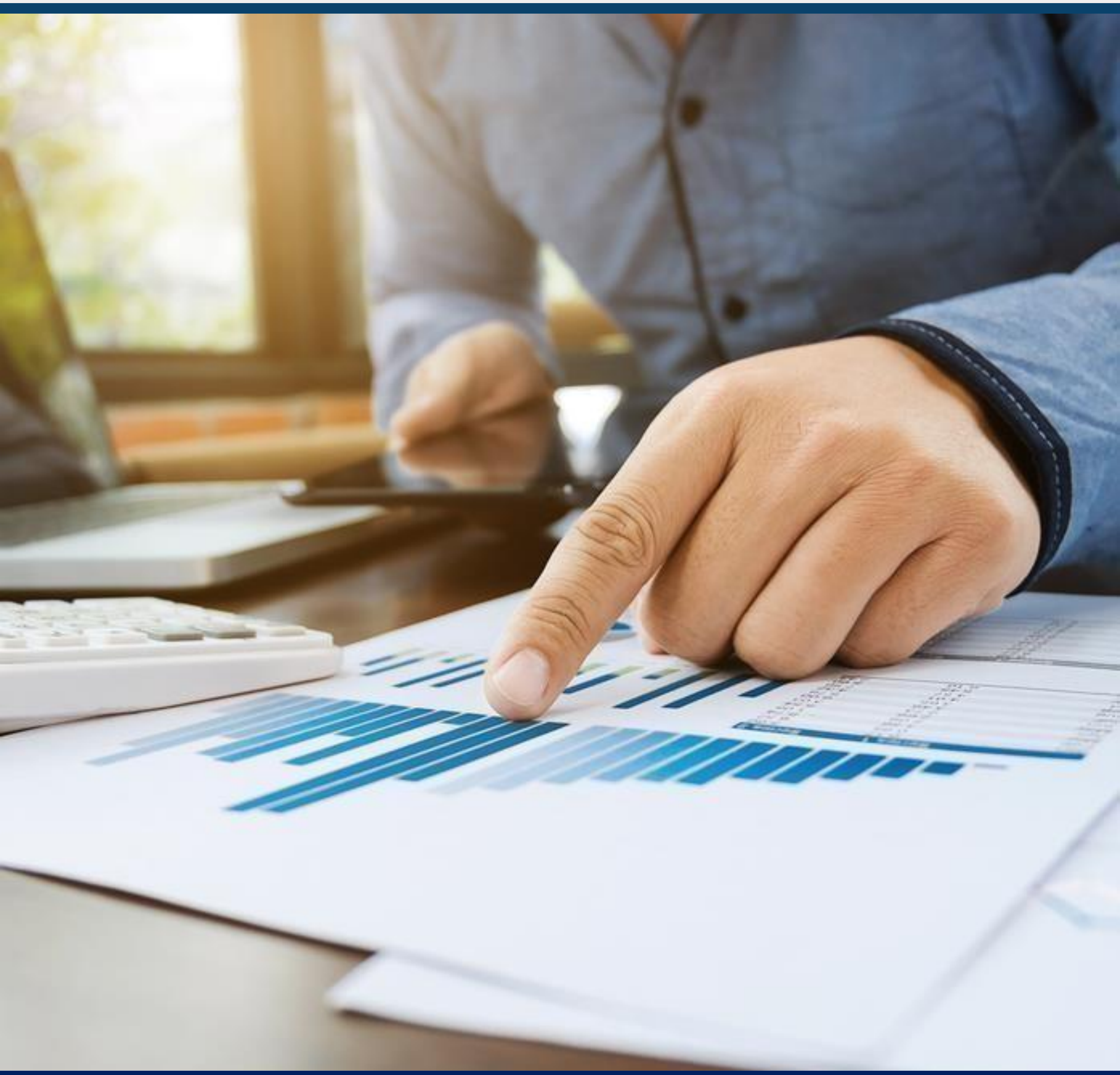
ASSURE

FEBRUARY 2022



Highlights of this issue:

1. **Exposure Drafts of revised accounting standards**
2. **Expert Advisory Opinion – Accounting treatment of Compulsorily Convertible Debentures (CCDs) under Ind AS 32, *Financial Instruments: Presentation***

1. Exposure drafts of revised accounting standards

With the aim to align the Accounting Standards (AS) with Indian Accounting Standards (Ind AS), the Accounting Standard Board ('ASB') of the Institute of Chartered Accountants of India ('ICAI') has proposed the following AS's which will replace existing AS's:

i. AS 103 Accounting for Amalgamations *(revising existing AS 14, Accounting for Amalgamations)*

ii. AS 110, Consolidated and Separate Financial Statements *(revising existing AS 21 Consolidated Financial Statements)*

iii. AS 111, Financial Reporting of Interests in Joint Ventures *(revising existing AS 27, Financial Reporting of Interests in Joint Ventures)*

iv. AS 28, Accounting for Investments in Associates and Jointly Controlled Entities. *(revising existing AS 23, Accounting for Investments in Associates in Consolidated Financial Statements)*

- Key highlights of proposed AS 103 as compared to existing AS 14 are as under:
  - It deals with 'amalgamation including business acquisitions' and covers 'transfer of business'.
  - Scope of the definition of 'amalgamation' is wider as it covers transfer of business also.
  - Definition of 'Amalgamation in the nature of Merger' is similar to 'Business Combinations under Common Control' as defined in Ind AS 103.
  - The date of amalgamation is the date on which the transferee obtains control of the transferor.
  - Amortising the goodwill arising on amalgamation in the nature of purchase over the period not to exceed 10 years. As per AS 14, this period was 5 years.
- Key highlights of proposed AS 110 as compared to existing AS 21 are as under:
  - Now there is single AS for both Consolidated and Separate Financial Statements.
  - In respect of definition of 'Control (of an entity)', AS 21 specified quantitative parameters (i.e. half of the voting powers) whereas revised AS 110 defines control as the power to govern the financial and operating policies of an entity.
  - As per definition, the Control of an entity can be with one entity only.
  - Difference between the date of the subsidiary's financial statements and that of the consolidated financial statements cannot exceed 3 months which was 6 months as per AS 21.
- Key highlights of proposed AS 111 as compared to existing AS 27 are as under:
  - Accounting of interest in a jointly controlled entity in the venturer's CFS will be using the equity method of accounting as against proportionate consolidation method as per AS 27.
- Key highlights of proposed AS 28 as compared to existing AS 23 are as under:
  - It covers accounting for associates and application of equity method to account for investments in associates and jointly controlled entities.
  - Definition of 'Significant Influence' is wider as compared to AS 23.
  - Difference in the reporting dates of the associate or joint venture shall be maximum 3 months.
  - No exemptions available from applying the equity method.
  - It provides guidance regarding accounting requirements in case the equity method is discontinued.

2. Expert Advisory Opinion

Accounting treatment of Compulsorily Convertible Debentures (CCDs) under Ind AS 32, *Financial Instruments: Presentation*

A. Background:

Expert advisory committee ('EAC') of the ICAI has issued an opinion in respect of accounting treatment of Compulsorily Convertible Debentures ('CCDs') by the issuer under Ind AS 32, Financial Instruments: Presentation.

ABC LTD. (hereinafter referred to as 'the Company') is jointly promoted by the two companies i.e. oil & gas extraction company and an oil marketing company (hereinafter referred to as 'the promoters'). The Company issued CCDs to NBFC's and Banks (hereinafter referred to as 'the investors'). The Company has an obligation to service the interest pay-outs during the tenure of the CCDs. Conversion of CCDs will be exercised at the end of the tenure/buy-out option or exercising of the put option by the investors and the Company would be required to convert the same into equity shares of the Company in the same proportion of shareholding. The terms of conversion are that the Company would issue shares to the promoters instead of investors and conversion price shall be determined on the basis of valuation at the time of such conversion. Thus, the liability of the Company is limited to the payment of interest to the investors as the value of CCD shall be paid by the promoters to the investors at the time of conversion.

Considering the unique features of the CCDs read with the terms of transaction documents, the legal point of view on the nature of the instrument is that, the consequence of infusion of funds by the promoters through CCDs will ultimately be an equity investment into the Company pursuant to the conversion of CCDs to equity shares of the Company; and such conversion is not optional but compulsory and does not contemplate repayment of the principal by the issuing Company. Hence, the CCDs issued by the Company can be characterised as equity-related instruments or quasi-equity instruments from the date of issuance of such CCDs by the Company and thus the Company classified the instrument as a compound instrument.

B. Key issues:

i. Whether the accounting treatment of CCDs issued by the Company and the disclosures made by the Company is in line with the requirement of Ind AS 32 and the applicable provisions of other Indian Accounting Standards?

ii. In case, EAC opinion is contrary to accounting treatment adopted by the Company:

   a) What is the correct accounting treatment that should have been followed in the matter?

   b) What are the corrective or remedial actions to be taken by the Company in this respect?

C. Basis of Opinion:

Ind AS 109, 'Financial Instruments'.

Ind AS 32, 'Financial Instruments: Presentation'.

Ind AS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors'.

D. Key Principles Applied & Conclusions:

➢ For issue (i)

As per Ind AS 32, while classifying a financial instrument as a liability or equity, equity classification is appropriate only if the instrument fails the definition of financial liability. An entity may have a contractual obligation to deliver a number of its own shares or other equity instruments that vary so that the fair value of the entity's own equity instruments to be delivered equals the amount of the contractual obligation. Such a contract is a financial liability.

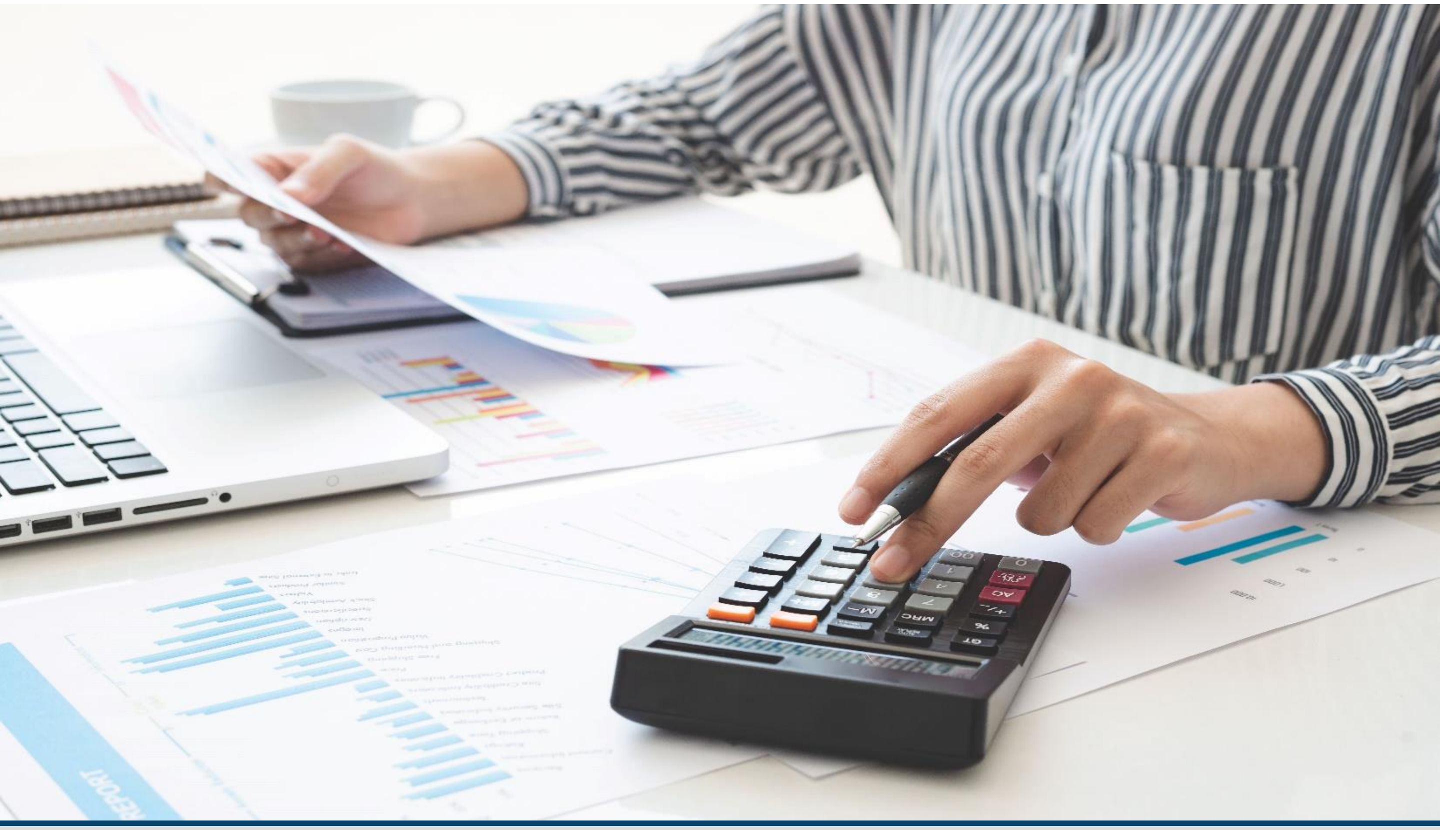
In the opinion of EAC, since interest is payable to the investors by the Company as per the terms of the CCDs, it would meet the criteria for financial liability classification as there is an obligation to pay cash that the issuer cannot avoid (interest payment obligation). Even though the contract must, or may, be settled through the delivery of the entity's own equity instruments, the number of its own equity instruments required to settle the contract will vary. The contract will therefore not fulfill the requirements of an equity instrument and is, therefore, a financial liability. Hence, the accounting treatment of CCDs issued by the Company as the compound instrument is not in line with the requirements of Ind AS 32.

The Company shall present and make the disclosures for the CCDs, as per the applicable requirements of Ind AS 32, Ind AS 107, Ind AS 113 and Division II – Ind AS Schedule III to the Companies Act, 2013 that are relevant for financial liabilities. Thus, the disclosures in the financial statements shall be provided based on the classification as financial liabilities.

- For issue (ii)

a) There is no contractual obligation to pay cash that the issuer (the Company) cannot avoid since the conversion into own equity shares is compulsory. The conversion price and the conversion ratio of CCDs into ordinary equity shares of the Company are not fixed at the point of initial recognition of the CCDs & will be decided at the time of conversion. Therefore, the conversion component within the instrument would not meet the criteria laid down in Ind AS 32 for the purpose of classifying it as equity. Thus, the CCDs shall be classified as financial liabilities in entirety under Ind AS 32.

b) As per Ind AS 8, the Company shall correct the accounting treatment of the CCDs as a prior period error retrospectively in the first set of financial statements approved for issue after the discovery of the error.



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