Evas International Plus

NEWSLETTER

Volume 3 / Issue 3

FREE ZONES IN UAE & IT'S TAX IMPACTS

MBR Explorer
UAE mission to asteroid belt:

SULTAN AL NEYADI

Bearing the successful fruits from Hope spacecraft, which is still circling and studying Mars, the space agency of United Arab Emirates announced on 28th May 2023 plans for an ambitious follow-up mission: a grand tour of the asteroid belt, Emirates Mission to the Asteroid Belt (EMA). "The UAE project to explore the asteroid belt is a huge national scientific project and a unique global research and knowledge project," tweeted His Highness Sheikh Mohammed Bin Rashid Al Maktoum, announcing the mission. It is extremely applaudable about the immaculate vision and passion of the UAE leaders on the application of science and technology for the benefit and upliftment of the mankind. The mission to asteroid belt besides its main objective of exploring mysterious asteroids, could also lay the foundation for future asteroid resource extraction, with the asteroid belt reportedly containing $700 quintillion worth of minerals such as iron, gold, and nickel. Evas International extends it warm wishes to the whole UAE EMA team for this exceptional initiative to explore and utilize the space and also earnestly pray for its successful accomplishment to help and serve the current and future generation in the UAE.

Table of Contents

Hello From Us

VIJAYA MOHAN
Managing Partner
Evas International

Dear Friends

As we complete the first half of the year 2023, it is yet another opportunity for us to sit back and have a look into the achievements, challenges and aspirations that have shaped our journey thus far. Many of us would have had ups and downs until now, but as they say, it is always imperative to take up new initiatives to progress in life. The UAE government has taken a great initiative by introducing Corporate Tax in UAE. An efficient tax collection and administrative system ensures the optimal management of a country's resources. The introduction of Corporate Tax Law gives rise to both new and improved opportunities and challenges. So, let’s embrace these happenings with EVAS International, for they mark the genesis of new and exciting chapters waiting to be written.

UAE being a land of remarkable diversity and captivating landscapes, where the concept of VAST-Vision, Ambition, Sustainability and Transformation is captured, introduction of Corporate Tax may have some perceived challenges. Even though taxation may have its complexities and challenges with respect to its recentness, it can bring about a wide range of benefits that contribute to the overall growth and well-being of the UAE and its citizens and residents. It can support economic stability by ensuring a sustainable revenue stream for the government. This stability provides an additional foundation for financial planning and budgeting, which can lead to better economic management. A well-designed tax system promotes fairness and equity in the society. By implementing progressive tax structures, the burden of taxation can be distributed more evenly, with higher-income individuals and corporations contributing a larger share. So, it’s the need of the hour to strike a balance between the tax paid by taxpayers and the benefit they derive from these taxes.

Hello From Us

As we have just concluded the festive season of Eid and Islamic New Year, are embarking on new chapters, let us draw inspiration from successes, learn from the challenges, and forge a future that is built upon the foundations laid by those who came before us. Let us remember that the way forward is not solely about achieving financial success but also making out a positive impact on the society and the planet. By integrating purpose, sustainability, and innovation into our business strategies, we can create a future where prosperity and well-being go hand-in-hand. Evas International was privileged to actively engage and contribute to the initiative by Khaleej Times for bringing the people together for a summit explaining the gamut of preparedness required to welcome Corporate Tax law. We, the Evas International team, are readily available for your assistance throughout the tax days and wish good luck for the upcoming tax journey.

On this brand-new edition, we are excited to present a collection of insightful and engaging academic topics, with an aim of providing our readers with a well-rounded and enriching reading experience. From the Corporate Tax desk, the current edition covers an article about the Free Zones in UAE and their relationships in multiple dimensions with Corporate Tax and VAT. In the past, there has always been inconsistency for the capitalization of the borrowing costs, and from the IFRS Desk, we have International Accounting Standard 23 'Borrowing Costs', which prescribes the uniform accounting treatment for borrowing costs and providing guidelines on the amount and timing for capitalization of the borrowing costs. In addition to the above, we bring you ISA 540, from our ISA desk, narrating the application of estimates in the financial statements, the responsibilities of the auditors about such estimates and the related disclosure requirements in the financial statements. Further, we provide you a glimpse on the upcoming event organized by the Institute of Chartered Accountants of India (ICAI), "Connecting the Globe, creating value". We believe that by expanding your knowledge and understanding across a variety of topics, you'll be equipped with the tools to navigate the complexities of the modern world, make informed decisions, and continue your path of personal and intellectual growth.

July 1 being the Indian Chartered Accountants Day, Evas International wishes all its readers a happy CA Day, for all your perseverance and interminable dedication.

With the famous thought from Mahatma Gandhi "Happiness is when what you think, what you say, and what you do are in harmony", I remain.

Happy Reading !

OUR WING FOR PROVIDING CORPORATE SERVICES

PROMPTUS GLOBAL
CORPORATE SERVICES

With us, Always Prompt

Creative ideas shape the world. We strongly believe that if we really adhere to a creative idea with consistent hard work and vision, the idea can serve a large business and professional community. Over the past years, there have been consistent restructuring seen done from the clients' side. Going for 100% ownership in limited liability company, concept of creating a head office/ holding company, importance of framework being amended consistent and compliant with its operations are among a few of them. We have often been approached by most of our treasured customers, for certain additional support services, like business establishment, company formation, corporate restructuring, etc, which until now were not fully catered by us. All new beginnings are fresh and encouraging, but what matters most is to maintain the journey and also to ensure its sustainability throughout with the same zeal and enthusiasm. And as business advisors, we have always upheld the value created in a business by its new initiatives and the need of continuous efforts for its existence and growth.

Now with that thought, the time has come for us to start our new business vertical, which will assist to create more value to our customers. We are extremely delighted to announce our new business initiative named as "Promptus Global". A service engine fuelled with immense energy and enthusiasm to serve the customers primarily for all your corporate services requirements. We don't limit ourselves in only satisfying our customers, but we create them as our value partners.

As is said "Whatever good things we built end up building us". We look forward, like before, to hear from our valuable clientele about how we improve in serving them. We take this opportunity to express our gratitude for letting us serve you all through out these years and we welcome all of you to join us in our joined journey carrying common goals and spirit.

OUR PROFESSIONAL TEAM

Sandeep Nair
Partner

Jamsheer
Senior Consultant

Praveen P Kumar
Business Development Manager

Free Zones In UAE & It's Tax Impacts

FREE ZONES AND ITS HISTORY

'Free zones' are enclosed areas within the customs territory of a country but considered to be outside the territory for customs duties, taxes, documentation, and issues to be covered by national legislation. Free zones have existed for several centuries. The generic free zone concept has evolved over time resulting in a variety of zones with different objectives, markets and activities. Free zones are developed to support economic reform, to act as "pressure valves" to alleviate growing unemployment, to serve as experimental labs for the application of new policies and approaches; and to attract Foreign Investments. In short, the primary establishment purposes of free zones are to increase foreign capital investments and foreign trade, to contribute to the international competitiveness of domestic manufacturers by providing them with inputs at the price of the world markets, to increase export by promoting the development of export-oriented industries, to increase inflow of foreign currency, to help solve the unemployment problem by creating new job opportunities, to raise economic standards by transferring advanced production and management techniques from around the worlds.

FREE ZONES IN THE UAE

In the UAE, the first Free Zone at Jebel Ali came into existence in the year 1985 and provided international businesses and corporations with a hub, which connected the East and the West and expanded the horizons of their operations. Primarily, starting a business within a Free Zone in the UAE exempts you from the duties usually imposed on foreign trading. A free zone company usually does not have any restriction on transference of profits to another country and not required to have a local partner to start their business. The UAE has gained a reputation as a global business hub, attracting companies from around the world to establish their presence within its borders. One of the key factors contributing to this appeal is the presence of numerous free zones offering attractive incentives and exemptions. These free zones provide businesses with the opportunity to operate within a designated area, benefit from streamlined regulations, and enjoy tax advantages.

The 100% foreign ownership allowed within the UAE free zones played a major role in the success of these zones. The UAE offered investors more than 40 multidisciplinary free zones, in which expatriates and foreign investors can have full ownership of companies. These zones are characterized by their highly efficient infrastructure, and distinct services that facilitate smooth workflows, saving businesses considerable time and effort.

BENEFITS OF FREE ZONES IN UAE FOR FOREIGN INVESTORS

- 100% Foreign Ownership
- 100% Repatriation of Capital and Profits
- Fast and Easy Business Set-up Procedures
- Developed Business Communities
- Numerous Options at Competitive Costs
- Exemption from Taxes
- Independent Laws and regulations
- Modern and Sophisticated Infrastructure
- Easy Regional Global Market Access

IMPACT OF TAX LAWS TO FREE ZONES

Prior to the year 2018, UAE had zero tax system, (in both Free Zones and Mainland) by which the businessmen across the world had taken advantage of these tax exemptions. However, with the introduction of VAT in 2018, the UAE's tax-free status was changed, and the businessmen had to shift their gears on tax planning and cash flow management. Nevertheless, the UAE Government granted specific tax benefits in both Value Added Tax (VAT) and Corporate Tax to entities located in specified free zones. Therefore, it is highly recommended to understand and have an expert knowledge about the various provisions of these tax laws for better conduct of business in these designated or free zones, which are discussed in the following sessions.

CONCEPT OF DESIGNATED ZONES

Designated Zones are those Free Zones which are nominated and listed in a Cabinet Decision which qualify for a special VAT treatment. The Federal Tax Authority (FTA) published 'Cabinet Decision No. (59) of 2017 on Designated Zones for the purposes of the VAT and listed the Free Zones which are notified as 'Designated Zones' for the purpose of VAT. (please refer Table A in page 08, for this detailed list of Free Zones which are Designated Zones). The same listed Designated Zones are equally applicable for the Corporate Tax law.

The application of VAT for designated zones differs depending on whether the supplies are made within the designated zone or involve movement of goods into or out of the zone. For this purpose, let us have a clear understanding of what designated zones are.

- Designated Zones are places **within the territory of UAE** which have been listed by the Cabinet Decision which qualify for a **special VAT treatment**.
- It must be a **specific fenced geographic area which is subject to strict control.** It must have **internal procedures** for keeping, storing and processing of **goods** within the Designated Zone.
- The **operator** of the Designated Zone must **comply with the procedures** set out by the FTA.
- They are treated as being **outside the territory of the UAE for VAT purposes** for certain supplies of **goods**.

TABLE A. THE LIST OF DESIGNATED ZONES AS PER THE CABINET DECISION

Dubai

- Jebel Ali Free Zone (North-South)
- Dubai Cars and Automotive Zone (DUCAMZ)
- Dubai Textile City
- Free Zone Area in Al Quoz
- Free Zone Area in Al Qusais
- Dubai Aviation City
- Dubai Airport Free Zone
- International Humanitarian City – Jebel Ali
- Dubai CommerCity

Ras Al Khaimah

- RAK Port Free Zone
- RAK Maritime City Free Zone
- RAK Airport Free Zone
- Al Hamra Industrial Zone – Free Zone
- Al Ghail Industrial Zone – Free Zone
- Al Hulaila Industrial Zone – Free Zone

Fujairah

- Fujairah Free Zone
- FOIZ (Fujairah Oil Industry Zone)

Abu Dhabi

- Free Trade Zone of Khalifa Port
- Abu Dhabi Airport Free Zone
- Khalifa Industrial Zone
- Al Ain International Airport Free Zone
- Al Butain International Airport Free Zone

Sharjah

- Hamriyah Free Zone
- Sharjah Airport International Free Zone

Umm Al Quwain

- Umm Al Quwain Free Trade Zone in Ahmed Bin Rashid Port
- Umm Al Quwain Free Trade Zone on Sheikh Mohammed Bin Zayed Road

Ajman

- Ajman Free Zone

VALUE ADDED TAX PROVISIONS AND DESIGNATED ZONES

The below table explains the applicability of provisions of VAT under different scenarios of supply of goods related to designated zones.

Scenario No	Supplier	Buyer	Supply type	Supply nature	Scope of VAT
Scenario 1	Company A, located in Designated Zone (DZ), JAFZA	Company B, located in Designated Zone (DZ), JAFZA	Supply of goods within DZ.	Since both the companies are located in DZ they are treated as being outside the UAE for supply for goods	The supply is Out of Scope under VAT rules
Scenario 2	Company A, located in Designated Zone (DZ), JAFZA	Company C, located in Designated Zone (DZ), SAIF Zone	Supply of goods between DZs.	Since both the companies are located in DZ they are treated as being outside the UAE for supply for goods	The supply is Out of Scope under VAT rules
Scenario 3	Company A, located in Designated Zone (DZ), JAFZA	Company D, located in Japan	Supply of goods from DZ to outside the country.	Since Designated Zones are treated as outside the UAE for VAT purposes, a movement or supply of goods from a Designated Zone to outside the UAE would be treated as taking place outside the UAE	The supply is Out of Scope under VAT rules

Scenario No	Supplier	Buyer	Supply type	Supply nature	Scope of VAT
Scenario 4	Company A, located in Designated Zone (DZ), JAFZA	Company E, located in Mainland, Dubai	Supply of goods from DZ to inside the country	For supplier, Company A - It is treated as outside the Scope of VAT. For buyer, Company E - It is treated as import of goods into Mainland. Therefore, Import VAT is payable by the customer under RCM.	The supply falls under the Scope of VAT rules, partially
Scenario 5	Company F, located in China	Company A, located in Designated Zone (DZ), JAFZA	Supply of goods from outside the country to DZ.	Since Designated Zones are treated as outside the UAE for VAT purposes, a movement or supply of goods into a Desig-nated Zone from outside the UAE would be treated as taking place outside the UAE.	The supply is Out of Scope under VAT rules
Scenario 6	Company G, located in Main-land, Dubai	Company A, located in Designated Zone (DZ), JAFZA	Supply of goods from Mainland to DZ.	For supplier, Company G - It is not considered to be an export of goods from the UAE. Normal provisions of VAT will apply and will be charged @ 5% For buyer, Company A- Such movements are treated as local movements. Input VAT can be recovered based on the tax invoice received.	The supply falls under the scope of VAT rules

Key aspects to keep in mind with regard to the above-mentioned scenarios of supply of goods.

A. For Scenarios 1 & 2

1. Care should be taken that the goods are not used or altered in anyway during its transit and transfer is undertaken in accordance with the rules of customs suspension.
2. Intention of the buyer, with respect to the usage of goods purchased. whether for **Resale or Consumption**. If the goods are purchased with an intension to consume, then this becomes a taxable supply and VAT will be charged @ 5%. Consumption means - any utilization, application, employment, deployment or exploitation of the goods i.e. it should be consumed by the customer and not used for resale. But if the purchased goods are used by the customer in the manufacturing or production process or incorporated into or forms part of another good in the same DZ and this manufactured/ produced good is for the purpose of sale, this is not defined as consumption. The end intension is resale and hence in this case it will be out of scope of VAT.

3. Please note the below diagram for easy understanding.

Standard rate @ 5%	A business in the Designated Zone buys an office computer, food, stationery, a company car, fuel for the company car, office furniture, and similar goods to be used in the general running of the business
Out of scope	A business buys trading stock for the purpose of resale within the Designated Zone
Out of scope	An oil equipment manufacturer in the Designated Zone buys steel which will be used in production of equipment. The manufactured equipment is then sold by the manufacturer

In the above supply of goods, it is the responsibility of the supplier to ensure that it treats a supply correctly for VAT purposes. The Supplier must receive a written statement from the recipient that the goods will not be consumed.

B. Special case where DZs are subjected to VAT @ 5%

The supply of goods by a Taxable person from the Designated Zone to the UAE mainland, is liable to VAT at the Standard rate of 5% if supply is made on **"Delivery at site/ Delivered Duty Paid (DDP)" incoterms.**

As per the UAE VAT Law, applicability of VAT is to be determined as per the place of supply rules. Since the place of supply for goods generally follows the location of the goods, it is to be noted, that when sale is made on a DDP basis, goods are physically located in the mainland where the place of supply gets crystallized.

The risk and title of goods is transferred when the goods are delivered at site to the customer. But, at the time of import of goods, customer is not the owner of goods as per the DDP Incoterms and hence adjustments are required to be done in value of imports in the VAT return by the supplier and the customer.

Supply of services in DZs

The concept of Designated Zones being treated as outside the UAE, in the case of supply of goods, does not apply to supply of services. The place of supply of any services is considered to be inside the State if the place of supply is in the Designated Zone. Such supplies are then taxed in accordance with the general VAT rules for supplies of services. This means that most services will be liable to VAT at the standard rate @ 5%, as would be the case if they were performed within the UAE.

Where services are exported (i.e. made to a person who is non resident and located outside the UAE), then the services may be zero-rated.

CORPORATE TAX PROVISIONS AND FREE ZONES

While qualifying free zones in the UAE generally provide tax exemptions, it is important for businesses to understand the intricacies of the taxability rules of qualifying free zones. In the following session, we try to explain various terminologies used in the relevant law and its application with respect to the taxation of the free zone companies in UAE.

Who is a Qualifying Free Zone Person (QFZP)

A Qualifying Free Zone Person is a Free Zone Person that meets all of the following conditions:

1. Maintains adequate substance in the State.
2. Derives Qualifying Income.
3. Has not elected to be subject to Corporate Tax.
4. Complies with Arm's length principle and Transfer pricing regulations.
5. Its non-qualifying revenue does not exceed 5% of the total Revenue or AED 5,000,000, whichever is lower.
6. Prepares audited financial statements.

A QFZ P that fails to meet any of these 6 conditions at any time, shall cease to be a QFZP from the beginning of the relevant Tax Period and for the subsequent four Tax Periods.

What is Adequate Substance?

A Qualifying Free Zone Person shall be said to have an adequate substance only when it undertakes its core income-generating activities in a Free Zone, have adequate assets, an adequate number of qualified employees, and incur an adequate amount of operating expenditures.
Activities can be outsourced to a Related Party or a third party in a Free Zone, provided the Qualifying Free Zone Person has adequate supervision of the outsourced activity.

What is a qualifying income (QI)?

QI includes:	QI excludes:
a. Income derived from transactions with other Free Zone (FZP), other than from Excluded Activities b. Income derived from transactions with a Non-Free Zone Person, but only in respect of Qualifying Activities and that are not Excluded Activities. c. Any other income, where the non-qualifying Revenue derived by the Qualifying Free Zone Person in a Tax Period does not exceed 5% of the total revenue or AED 5,000,000, whichever is lower.	a. Income attributable to a Domestic Permanent Establishment or a Foreign Permanent Establishment b. Income attributable to ownership or exploitation of immovable property

Income will be considered as derived from transactions with FZP, only when that FZP is the **Beneficial Recipient** of the relevant Goods or Services.

Beneficial Recipient is a Person who has the right to use and enjoy the service or the Goods and does not have a contractual or legal obligation to pass them to another person.

Qualifying and Excluded Activities

QUALIFYING ACTIVITIES

- Manufacturing of goods or materials.
- Processing of goods or materials.
- Holding of shares and other securities.
- Ownership, management and operation of Ships.
- Reinsurance services.
- Fund management services.
- Wealth and investment management services.
- Headquarter services to Related Parties.
- Treasury and financing services to Related Parties.
- Financing and leasing of Aircraft, including engines and rotable components.
- Distribution of goods or materials in or from a **Designated Zone** (please refer Table A given in page 08) to a customer that resells such goods or materials, processes or alters such goods or materials for the purposes of sale or resale.
- Logistics services.
- Ancillary activities to the above.

EXCLUDED ACTIVITES

- Transactions with natural persons, except transactions under Qualifying Activities in relation to Ships, aircrafts, fund management, wealth and investment management.
- Banking activities
- Insurance activities (other than reinsurance)
- Finance and leasing activities
- Ownership or exploitation of immovable property, other than Commercial Property located in a Free Zone
- Ownership or exploitation of intellectual property assets.
- Ancillary activities to the above.

Excluded Qualifying Income

Income Attributable to a Domestic Permanent Establishment or a Foreign Permanent Establishment

Taxable Income of any such establishment for that period calculated as if the establishment was a separate and independent Person that is a Related Party of the Qualifying Free Zone Person.

Such income shall be considered Taxable Income and taxed @ 9%.

Income Attributable to Immovable Property Located in a Free Zone

Income attributable to immovable property located in a Free Zone that is derived from the below transactions shall be considered Taxable Income and taxed @ 9%.

- Transactions with Non-Free Zone Persons in respect of Commercial Property.
- Transactions with any Person in respect of immovable property that is not Commercial Property.

Tax Rates applicable in Free Zones

For **Qualifying Income,** the tax rates is **0% (Nil)**	For **Non- Qualifying** Income, the tax is at **9%.**

Conclusion

Many UAE businesses may face certain challenges in the upcoming unfamiliar Corporate Tax journey, while they start complying with the new federal corporate income tax. Besides compliance with the new Corporate Tax law, the business houses need to shift their business plans and strategies to effective management of cash flow, transactions with related parties and maintenance of legal and supporting documents of financial transactions. With a holistic understanding and compliance with the recent tax provisions applicable to the free zones in UAE, the businessmen shall be able to continue with the benefits on having business establishments in the UAE free zones. It is more of a matter related to tax planning and adherence, which shall ease the conduct of business in these free zones. In this journey, Evas International wishes all the business houses good luck and promises to be available for all support and assistance for a better value creation in your organization.

IAS 23: "BORROWING COSTS"

INTRODUCTION

In simple terms, borrowing costs are the interest expenses incurred by a company in connection with the borrowing of funds. Many companies incur borrowing costs for the construction of assets. These companies need to know how to account for these costs. International Accounting Standard 23 (IAS 23) prescribes the accounting treatment of borrowing costs and gives guidelines on determining the amount and timing for the capitalization of the borrowing costs. Application of IAS 23 reduces the risk of incorrect capitalization of borrowed costs, resulting in accurate valuation of assets.

Borrowing costs may include the following:

- interest expense, finance charges in respect of finance leases, and foreign exchange differences if they are regarded as an adjustment to interest costs

This standard does not cover the actual or imputed cost of equity.

In this article, we try to elaborate on what is a qualifying asset, when the capitalization of the borrowing costs shall start, when it stopped and what is the amount to capitalize. At the end of reading this article, one shall be able to identify the borrowing costs to capitalize and calculate the amount of borrowing costs eligible for capitalization.

OBJECTIVES OF BORROWING COSTS

Basic principles apply to the capitalization of borrowing costs:

1. borrowing costs that are directly attributable to the acquisition, construction, or production of qualifying assets shall be capitalized as part of the cost of that asset.
2. all other borrowing costs are recognized as an expense in the period they are incurred.

When an asset is acquired by its own funds, there is NO borrowing costs

Borrowing costs are capitalized only when it is probable that they will result in future economic benefits to the enterprise and the costs can be measured reliably.

QUALIFYING ASSETS

As per IAS 23.5, qualifying asset means an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Professional judgement shall be applied to assess the substantial period of time. In general parlance, it can be more than one year. The following are non-qualifying assets

A. Assets that are ready for their intended use or sale when acquired
B. Financial assets and
C. Inventories that are manufactured or otherwise produced over a short period of time.

Example of a qualifying asset
Construction of Warehouses

Example of a non-qualifying asset
Investment property ready for sale

COMMENCING CAPITALIZATION

The capitalization of the borrowing costs, with respect to the qualifying assets shall start when all these following conditions are met:

- A. **Expenditures** on qualifying assets are incurred.
- B. The Company has **incurred borrowing costs**.
- C. **Activities** that are necessary to prepare the qualifying asset for its intended use or sale are in progress. The administrative work is also considered as an activity.

A company has acquired a land for constructing a building on it. But the project is put on hold. As the company currently does not carry out any activities on the land, the Borrowing Costs incurred on such purchase of land **do not qualify** for capitalization, as there is no activity being held.

STOPPING CAPITALIZATION

A. SUSPENSION

- A. Capitalization of the borrowing costs shall be suspended, during extended periods, in which active developments are interrupted.
- B. The period during which substantial technical and administrative work for the development of a qualifying assets is carried out, is considered to be an activity and hence the capitalization of the borrowing costs for this period is NOT suspended.
- C. Capitalization of the borrowing costs shall NOT be suspended, when there is temporary delays, which is a necessary part of the process getting an asset ready for its intended use or sale.

Capitalization of the borrowing costs incurred for the construction of a school would be suspended when construction activities are halted over an extended period of time due to shortage of government funds.

B. CESSATION

When substantially all the activities necessary to prepare the qualifying asset for its intended use or sale is completed, the capitalization of the borrowing costs shall CEASE. That is to say, borrowing costs cannot be capitalized after the physical asset is ready to use except for some minor changes, like door fitting, etc.

C. COMPLETED IN STAGES

When the construction of qualifying assets is completed in parts and each part can be separately used or sold, then the capitalization of borrowed costs for that part of qualifying assets which is ready for use or sale, shall cease.

AMOUNTS TO CAPITALIZE

A. SPECIFIC BORROWINGS

If funds are borrowed specifically for the purpose of acquiring a qualified asset, then the actual borrowings costs incurred on that borrowing for that period shall be eligible for capitalization. Sometimes, it may happen that the borrowed funds shall not be immediately used and be invested for a shorter period until its usage comes. In such case, any income arising from such invested funds shall be deducted from borrowing costs.

B. GENERAL BORROWINGS

When the company has multiple borrowings and is not in a position to identify the borrowings used specifically for the construction of qualifying assets, the amount of borrowing costs eligible for capitalization is calculated by applying a capitalization rate on the average carrying amount of that asset

The Capitalization rate is the weighted average of the borrowing costs applicable to the borrowings of the company that are outstanding during the period.

The average carrying amount of the asset (including borrowing costs previously capitalized) is normally a reasonable approximation of the expenditures to which the capitalization rate is applied in that period.

The amount of borrowing costs capitalized shall not be more than the actual borrowing costs incurred for that period.

A CASE STUDY

Anaska is a multinational investment company primarily engaged in investing in ready built shopping complexes and office buildings world-wide. Currently the company is carrying out a massive project of constructing a new shopping complex in India which is expected to complete in coming 3 to 4 years. The application of IAS 23 at different point of time for this company is discussed below:

A. Is the Shopping Complex a qualifying asset?
Yes, as it takes substantial period of time to get ready for its intended use.

B. Are the borrowing costs on the funds raised to meet the registration expenses of these properties can be capitalized?
Yes, as these borrowing costs would have been avoided if the expenditure on the qualifying asset had not made.

C. The following are the details of expenditure incurred and the related borrowings. Please calculate the amount of borrowing costs to capitalize, assuming the capitalization rate at 9% and the year ended is 31st December 2022.

Date of borrowing	Date of borrowing	Purpose of borrowing
15th March 2022	US$ 10,000	Payment of registration fees
1st June 2022	US$ 75,000	Maintenance of Indian office
15th July 2022	US$ 100,000	First progress payment

Answer

The expenditures related to maintenance of Indian office do not qualify for capitalization. The other two costs are eligible and the related borrowing costs is calculated in the following manner:

Date	Amount borrowed	No of months until year end	Borrowing costs to capitalize	Remarks
15th March 2022	US$ 10,000	9.5	US$ 712.5	(10,000*9.5/12*9%)
1st June 2022	US$ 75,000	7	Nil	This expenditure do not qualify for capitalization, as there is no qualifying asset
15th July 2022	US$ 250,000	6	US$ 11,250	(250,000*6/12*9%)

Disclosure Requirements:

Entities are also obligated to disclose the accounting policy adopted for borrowing costs. This includes the capitalization rate used, the amount of borrowing costs capitalized during the period, and any significant judgments or assumptions made in the application of the standard.

Conclusions:

IAS 23, Accounting for Borrowing Costs, plays a vital role in ensuring the appropriate treatment of borrowing costs associated with qualifying assets. By providing clear guidelines on capitalization and expense recognition, this standard enhances transparency and consistency in financial reporting. Entities must diligently apply IAS 23, considering the specific requirements and challenges to accurately reflect the true costs incurred in acquiring or producing assets.

ISA 540:

"Auditing Accounting Estimates and Related Disclosures"

Accounting estimate is a technique to measure those items in financial statements that have no accurate quantification and therefore estimated based on judgement and knowledge derived from experience. It varies widely in nature and are required to be made by management when the monetary amounts cannot be directly observed or measured, and such measurement have estimation uncertainty, complex and subjective, and therefore carries an inherent risk on its correct measurement. Making these estimates involves selecting and applying a method, using assumptions and data, which requires judgment. Since these estimates are based on assumptions and judgements, these estimated amounts may be susceptible to errors and misstatements of the financial statements.

In this article, we try to bring out the application of ISA 540 – the responsibilities of an auditor relating to the accounting estimates and related disclosures in the financial statements. The scope of this ISA includes requirements and guidance on the evaluation of misstatements of accounting estimates and related disclosures and indicators of possible management bias.

ACCOUNTING ESTIMATES

Accounting estimate is an approximation of a monetary amount in the absence of a precise means of measurement. It involves subjective judgment and uncertainty, as it requires management to make assumptions and select accounting policies based on available information. These estimates may include (other than fair value estimates):

Items	Description
Allowance for doubtful debts	Involves assessing the likelihood of customers defaulting on their payments and the expected recovery of the amounts owed.
Inventory obsolescence and valuations	The valuation of inventory can have a significant impact on the company's financial statements, especially for companies with large inventory balances or where the cost of raw materials may fluctuate significantly.
Depreciation method and useful life of assets	Management may need to estimate the useful life of assets such as buildings, machinery, and equipment, which can impact the depreciation expense and the company's profitability.
Financial obligations / cost arising from litigation settlement and judgements	Litigation settlements involves the estimation of potential liabilities that may arise from legal disputes or claims against the company. Management may estimate the likelihood and amount of the settlement based on legal advice and available information.

Items	Description
Impairment assessments	It involves assessing whether the value of long-lived assets such as property, plant, and equipment, has been impaired due to factors such as technological developments, competition, or changes in the market.
Outcome of long-term contracts	In case of pension obligations, the companies may have to estimate their obligations related to defined benefit pension plans, which can be complex and subject to significant uncertainties.
Revenue recognition (IFRS 15)	It involves determining the timing and amount of revenue that is to be recognized in the financial statements if the nature of the revenue is subject to significant estimation or judgement, such as long-term contracts or complex sales arrangements.
Warranty obligations	When a company sells a product with a warranty, it incurs an obligation to provide repairs or replacements if the product fails within the warranty period. To account for this warranty obligation, the company needs to estimate the future costs it expects to incur. This estimate involves considering historical warranty claim data, product failure rates, repair costs, and other relevant factors.

Examples on fair value measurements

Share based payments (IFRS 2)	Share-based payment is a common accounting estimate made by management, which involves the issuance of equity instruments to employees or other parties as compensation for their services or to settle liabilities. The valuation of the equity instruments may be subject to estimation.
Business combination	Certain assets or liabilities acquired in a business combination, including goodwill and intangible assets.
Exchange of assets or liabilities	Transactions involving the exchange of assets or liabilities between independent parties without monetary consideration, for example, a non-monetary exchange of plant facilities in different lines of business.
Property and equipment held for disposal	In this case, the entity needs to estimate the amount it expects to receive from the sale after deducting any costs associated with the disposal (fair value less cost to sell).

OBJECTIVE OF ISA 540

The objective of the auditor is to obtain sufficient appropriate audit evidence about whether accounting estimates and related disclosures in the financial statements are reasonable in the context of the applicable financial reporting framework.

RISK ASSESSMENT PROCEDURES AND RELATED ACTIVITIES

An auditor shall assess the risk related to reliance on the accounting estimates carried out by the management. The following are the main points to be kept in mind by an auditor while carrying out the risk assessment procedure:

- Obtain an understanding of the entity and its environment.
- Scalability – in case the estimates used by the management for the preparation of financial statements are significant, the risk assessment and audit procedures will be lengthy or otherwise.
- The entity's transactions and other events and conditions.
- The requirement of the applicable financial reporting framework.
- Regulatory factors.
- The nature of the accounting estimates and related disclosures that the auditor expects to be included in the financial statements.
- Entity's internal control relevant to the audit - The nature and extent of oversight and governance.
- Understanding about those charged with governance.
- Entity's risk assessment process.
- The entity's information system relating to the accounting estimates.
- Management's identification of the relevant methods, assumptions and source of data.
- How management understands and address the estimation uncertainty.
- Review the outcome or re-estimation of previous accounting estimates.
- Specialized skills or knowledge.

SCENARIO

ABC Retail is a multinational company that operates a chain of retail stores. As part of its financial reporting process, ABC Retail makes accounting estimates related to inventory valuation and revenue recognition.

At first, the auditor gains an understanding of how ABC Retail determines its inventory valuation and revenue recognition estimates. The auditor reviews the company's policies, procedures, and the methods used to calculate these estimates, such as the cash flow assumption, discounts, and allowances applied.

The auditor also identifies the risks associated with inventory valuation and revenue recognition estimates in the retail industry. The auditor considers factors such as the seasonality of sales, changes in consumer preferences, potential shrinkage or obsolescence of inventory, and the impact of any promotional activities or discounts on revenue recognition.

Auditors should also consider external factors such as market conditions, regulatory changes, and technological advancements that may impact the estimation process. By identifying and assessing these risks, auditors can tailor their audit procedures accordingly and focus on areas with higher inherent risk.

IDENTIFYING AND ASSESSING THE RISKS OF MATERIAL MISSTATEMENT

In identifying the risks of material misstatement and in assessing the inherent risks, the auditor is required to taken into account the degree to which the accounting estimate is subject to or affected by estimation uncertainty, complexity, subjectivity or other inherent risk factors. By estimation uncertainty we mean, susceptibility to an inherent lack of precision in measurement. The auditor shall determine whether any of the risks of material misstatement identified and assessed carries a significant risk. If the auditor has determined that a significant risk exists, the auditor shall obtain an understanding of the entity's control, including control activities relevant to that risk.

RESPONSES TO THE ASSESSED RISKS OF MATERIAL MISSTATEMENT

To address the risks identified, this ISA requires auditors to design and perform audit procedures that provide sufficient and appropriate audit evidence. This may involve:

- Testing management's estimation methods and the related internal controls.
- Analysing the sensitivity of the estimate to changes in key variables.
- Evaluating the underlying data and assumptions.
- Assessing the consistency of its application across the reporting periods and with related assumptions used in other areas of the entity's business activities.
- Ensuring that estimates are reasonable and appropriate in the context of the applicable financial reporting framework.

Auditors should exercise professional skepticism and challenge management's estimates and they should also consider engaging the expertise of specialists when necessary to validate complex or significant estimates. (For example, the accounting estimate may involve measurement of mineral or hydrocarbon reserves in extractive industries or the evaluation of the likely outcome of applying complex contractual terms).

SCENARIO (Continuation of the previous mentioned scenario)

Evaluating management's process:
The auditor evaluates the competence and objectivity of the individuals responsible for making the estimates. They assesses the adequacy of ABC Retail's internal controls over inventory management, including procedures for physical stock counts, inventory tracking systems, and the segregation of duties.

Testing the reasonableness of estimates:
The auditor selects a sample of inventory items and independently verifies their existence, condition, and valuation. The auditor compares the recorded inventory values with market prices, supplier invoices, and any relevant industry benchmarks to assess the reasonableness of ABC Retail's estimates.

Assessing the appropriateness of revenue recognition:
The auditor reviews the revenue recognition policies of ABC Retail, focusing on areas such as sales returns, discounts, loyalty programs, and gift card liabilities. The auditor assesses if the company's revenue recognition practices comply with applicable accounting standards and whether they accurately reflect the economic substance of the transactions.

Evaluating the sufficiency of supporting evidence:
The auditor requests documentation supporting the inventory valuation and revenue recognition estimates, such as purchase orders, sales contracts, invoices, and supporting calculations. The auditor evaluates the reliability and relevance of this evidence to determine if it adequately supports the reasonableness of the estimates.

DISCLOSURES RELATED TO ACCOUNTING ESTIMATES

The auditor shall design and perform further audit procedures to obtain sufficient and appropriate audit evidence regarding the assessed risks of material misstatement at the assertion level for disclosures related to an accounting estimate.

- In the case of a fair presentation framework whether management has included disclosures, beyond those specifically required by the framework, that are necessary to achieve the fair presentation of the financial statements as a whole.
- In the case of a compliance framework, whether the disclosures are those that are necessary for the financial statements not to be misleading.

WRITTEN REPRESENTATIONS

The auditor shall request written representations from management and when appropriate, those charged with governance about whether the methods, significant assumptions and the data used in making the accounting estimates and the related disclosures are appropriate to achieve recognition, measurement or disclosure that is in accordance with the applicable financial reporting framework.

COMMUNICATION AND REPORTING

The auditor is required to communicate the significant matters related to accounting estimates to management and those charged with governance including the key assumptions made, inherent risks factors in making the accounting estimates, the effects of complexity, subjectivity and uncertainties involved. This promotes transparency and helps the stakeholders to understand the basis for auditors' conclusions.

Conclusion

This ISA serves as a comprehensive guide for auditors in addressing the challenges associated with accounting estimates. By adhering to this standard, auditors can enhance the quality of their audit report and provide assurance on the reasonableness of accounting estimates, thereby increasing stakeholders' confidence in the financial statements.

GLOPAC

"CONNECTING THE GLOBE, CREATING VALUE"

GloPAC 24th-26th Nov, 2023
GLOBAL PROFESSIONAL ACCOUNTANTS CONVENTION
Connecting the Globe, Creating Value

From November 24 to 26, 2023, The Institute of Chartered Accountants of India (ICAI) is organizing its first ever "Global Professional Accountants Convention" (GloPAC) on the theme- "Connecting the Globe, Creating Value". As the theme envisages, this jumbo event aims to bring together all the stake holders such as accountants, thinkers, policy makers, standard setters, industry and commerce groups and financial institutions from across the world to network, ponder upon and debate on the current professional challenges, to understand the unseen forces in the global economy, to evaluate further the regulatory landscape and to assess and formulate the future trends concerning the accountancy profession, which in return shall create value for each individual participant. It is noteworthy that the role of accountants is not only pivotal for economic reasons but for social developments too. This event provides an apt platform for the global and local stakeholders for interactive discussions and get updated with the knowledge from current issues and exchange their views regarding how to sustain in a crisis. This is a Golden opportunity to connect, be inspired, to network and to accelerate.

Borrowing the words of CA Aniket S. Talati, the president of ICAI, "GloPAC is more than just a conventional gathering of accounting and finance professionals. ICAI is committed to delivering the right platform that creates a powerful ecosystem for accounting professionals, facilitates commerce, and shares valued insights on the issues and challenges of the profession. Whether you're an SMP, or associated with a global firm, or working in an Industry, GloPAC would provide a unique opportunity to network and collaborate with like-minded professionals for your growth".

Like India being one of the oldest civilizations in the world, the profession of accountancy in India goes back to the 4th century BC as it is mentioned in Kautilya's 'Arthshastra' about accounting being an integral part of economics. In the modern era, the rest of the world looks up to India as it brings forth a wide range of opportunities to the world of accountants and business, because of the following features:

- **Large, economical talent pool of global accountants.**
- **One of the World's fastest-growing economies.**
- **Most attractive destination of IT companies across the world.**
- **One of the biggest and best business outsourcing providers in the world.**
- **Global innovation hub and the world's largest start up ecosystem.**
- **A country of youth.**

A participant should aim to take away the following upon associating with this mammoth event.

- **To have the Insights on global practice and future trends with emerging avenues for the profession.**
- **To build your network with peers across the Globe.**
- **To know how the accounting & finance professionals are changing the world for the better.**
- **To grow your practice with valuable learnings from the stalwarts of the profession.**
- **To have the economic insights to help you to plan better.**
- **To be informative and practical sessions led by experts.**
- **To learn from the trend setters on the challenges to face the uncertain tomorrow.**

GloPAC 24th-26th Nov, 2023
GLOBAL PROFESSIONAL ACCOUNTANTS CONVENTION
Connecting the Globe, Creating Value

PROGRAM AT A GLANCE

24 November 2023, Friday

12:00 noon onwards: Registration	17:00 - 18:30: Technical Session/Parallel Workshops
15:00 - 16:30: Inaugural Session	18:30 - 19:30: Networking & Exhibition Break
16:30 - 17:00: Break	19:30 onwards: Cultural Evening followed by dinner

25 November 2023, Saturday	26 November 2023, Sunday
10:00-11:30: Technical Session/Parallel Workshops	10:00-11:30: Technical Session/Parallel Workshops
11:30 - 13:00: Technical Session/Parallel Workshops	11:30 - 13:00: Technical Session/Parallel Workshops
13:00 - 14:30: Exhibition & Working Lunch	13:00 - 14:00: Exhibition & Working Lunch
14:30 - 16:00: Technical Session/Parallel Workshops	14:00 - 15:30: Technical Session/Parallel Workshops
16:00 - 16:30: Break	15:30 - 16:00: Break
16:30 - 18:00: Technical Session/Parallel Workshops	16:00 - 17:00: Technical Session/Parallel Workshops

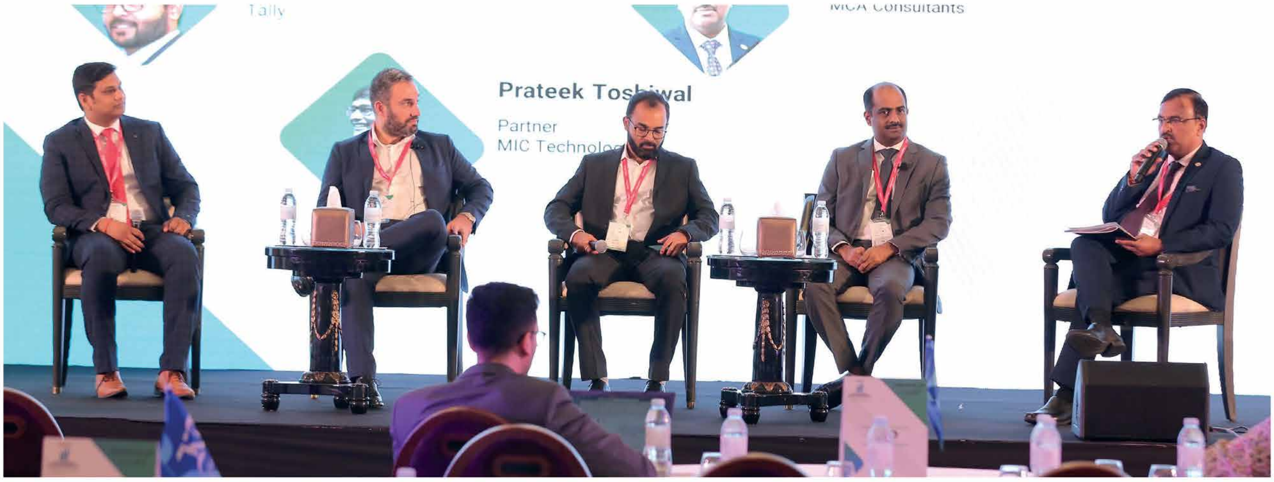
EVENTS

Sharjah Office Inauguration

EVENTS

Evas International has been proud to be one of the Strategic Sponsor of the event "Corporate Tax Decoded" and our Managing Partner, Mr. Vijaya Mohan, had an opportunity to share his thoughts in the panel discussion, emphasising about "the Compliance and Initiatives required by the Companies, with the introduction of CT in UAE".

14 **CORPORATE TAX DECODED** FRIDAY, JUNE 23, 2023 **KHALEEJ TIMES**



Vijay Mohan, managing partner, EVAS International; Ashkan Parpinchee, sales & marketing director, Crowe UAE; Nandaraja Shetty, senior country manager, Tally; Prateek Toshiwal, partner, MIC Technology; and Venkatesh S, managing partner, MCA Consultants, discuss an industry -wise perspective on the compliance requirements of corporate tax.

Source: www.thenationalnews.com. (Date: Apr 12, 2023)