Accounting & Ind AS
Pharma Industry

Contents

MCA Roadmap for Ind AS Implementation

As per MCA notification issued on 16 February 2015, implementation roadmap for Ind AS is as follows:

Phase 1

- Companies listed in or outside India (debt/ equity) with net-worth Rs. 500 Crores or more
- Unlisted companies with net-worth of Rs. 500 Crores or more
- Holding, subsidiary, JV or associate companies of aforesaid companies

2015-16		2016-17	
April	March	April	March
Opening Balance Sheet 1 April 2015	Comparative for 31 March 2016		Financial statements for year ended 31 March 2017

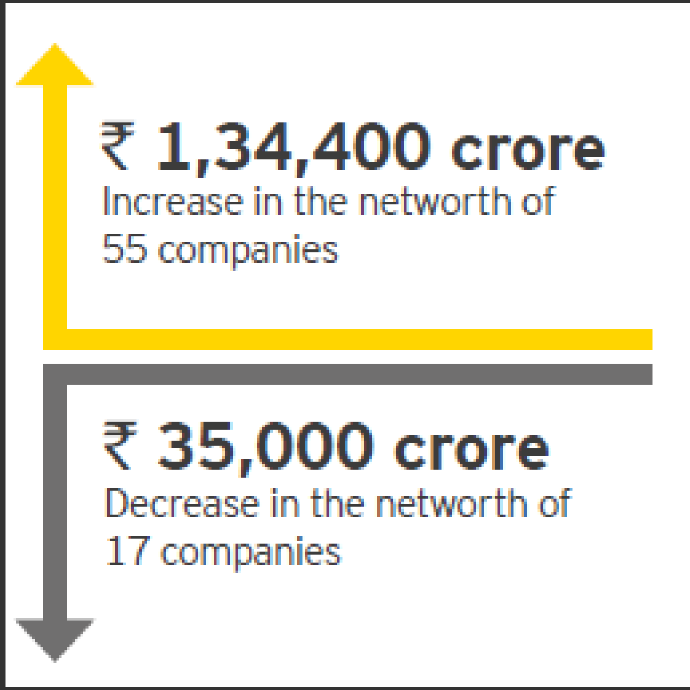
Phase 2

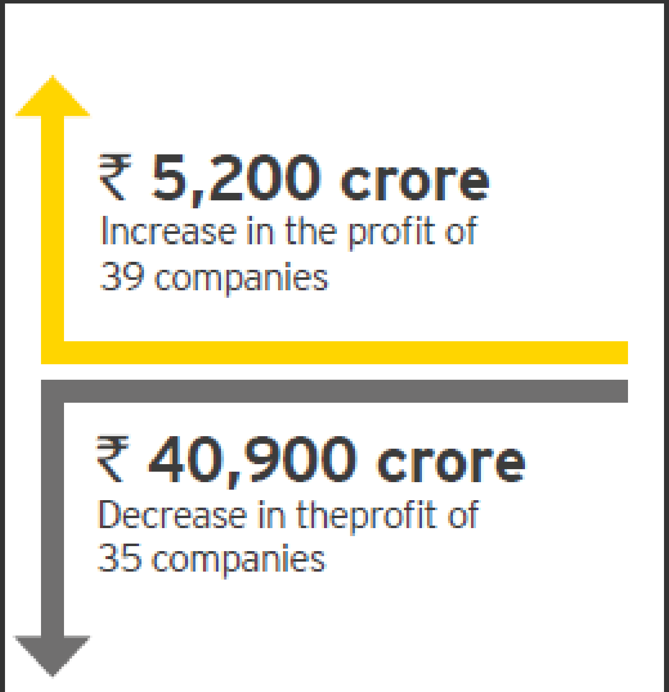
- All other listed companies
- Unlisted companies with net-worth of Rs. 250 Crores or more
- Holding, subsidiary, JV or associate companies of aforesaid companies

2016-17		2017-18	
April	March	April	March
Opening Balance Sheet 1 April 2016	Comparative for 31 March 2017		Financial statements for year ended 31 March 2018

Transition to Ind AS*

Impact on Headline Numbers





- Mixed Trend of Impact on various other KPIs such as Revenue, EBITDA and PAT
- Net Worth change driven significantly on account of First Time Transition Choices made

** Source: EY Publication on 'Ind AS Transition (Journey of Indian Corporates)' (July 2017)*

Transition to Ind AS – Pharma Sector
Impact on Headline Numbers

Net worth impact	Negative	Positive
Automobiles and transportation	(107)	9,296
Consumer/Industrial products and retail	(2,293)	16,994
Mining and metals	(25,916)	5,854
Oil and gas	(386)	49,438
Pharmaceuticals and chemicals	(353)	5,750
Real estate, Infrastructure, power and utilities	(3,795)	3,503
Technology (IT/IES)	-	15,338
Telecom, media and entertainment	(2,217)	28,230
Grand total	(35,067)	1,34,404
Number of companies	17	55

Net profit impact	Negative	Positive
Automobiles and transportation	(551)	1,763
Consumer/Industrial products and retail	(1,621)	1,036
Mining and metals	(24,929)	-317
Oil and gas	(8,919)	1,031
Pharmaceuticals and chemicals	(1,145)	117
Real estate, Infrastructure, power and utilities	(409)	688
Technology (IT/IES)	(3,133)	713
Telecom, media and entertainment	(201)	254
Grand total	(40,908)	5,285
Number of companies	35	39

** Source: EY Publication on 'Ind AS Transition (Journey of Indian Corporates)' (July 2017)*

Transition to Ind AS – Pharma Sector
Impact on Headline Numbers

Revenue impact	Negative	Positive
Automobiles and transportation	(1,169)	295
Consumer/Industrial products and retail	(5,493)	28
Mining and metals	(126)	4,375*
Oil and gas	(7,232)	0
Pharmaceuticals and chemicals	(246)	119
Real estate, Infrastructure, power and utilities	(229)	4,568*
Technology (IT/IES)	(808)	42
Telecom, media and entertainment	(59)	0
Grand total	(15,362)	9,427
Number of companies	53	14

EBITDA impact	Negative	Positive
Automobiles and transportation	(354)	1,997
Consumer/Industrial products and retail	(797)	1,169
Mining and metals	(23,071)	722
Oil and gas	(830)	2,105
Pharmaceuticals and chemicals	(557)	163
Real estate, Infrastructure, power and utilities	(512)	1,035
Technology (IT/IES)	(3,177)	599
Telecom, media and entertainment	(616)	303
Grand total	(29,914)	8,092
Number of companies	30	45

** Source: EY Publication on 'Ind AS Transition (Journey of Indian Corporates)' (July 2017)*

Transition to Ind AS
Standards that made their presence felt*

Ind AS 101 – First Time Transition

₹ 43,900 crore
Increase in net worth of 3 companies due to fair value of PPE

₹ 68,600 crore
Increase in net worth of 2 companies due to fair value of investments in group companies

₹ 26,600 crore
Decrease in net worth of 4 companies due to fair value of PPE

₹ 630 crore
Decrease in net worth of 1 company due to fair value of investment in group companies

Ind AS 109 – Financial Instruments

₹ 55,000 crore
Increase in net worth of 47 companies due to fair value of financial instruments

₹ 4,000 crore
Decrease in net worth of 13 companies due to ECL

₹ 3,300 crore
Decrease in net worth of 9 companies due to fair value of financial instruments

Ind AS 10 – Events after BS Date

₹ 30,000 crore
Increase in net worth of 23 companies at transition date

₹ 50,000 crore
Increase in net worth of 54 companies at March 2016

** Source: EY Publication on 'Ind AS Transition (Journey of Indian Corporates)' (July 2017)*

Key Impacts noted

Standards	Key Adjustments
Financial Instruments	▶ Fair value change of derivative and Investments ▶ Expected credit losses recognized ▶ Application of EIR
Revenue Recognition	▶ Netting off of cash discounts & Incentives from Revenue ▶ Collaboration arrangements, Contract Manufacturing, Out-licensing arrangements ▶ Profit/Royalty Share arrangements
Business Combinations	▶ Fair valuation of assets & liabilities on acquisition and recognition of intangibles even if not recorded in the books of the seller. ▶ Impact of reversal of previously amortized goodwill ▶ Ind AS 101 exemption pertaining to retrospective restatement of past business combinations
Others	▶ Componentization of fixed assets ▶ Recognition of Outsourcing arrangements as deemed leases. ▶ Recognition of Intangibles/Brands not recognizable under previous IGAAP ▶ Change in cost due to fair value accounting of Share based payments

The Accounting Change

1

Ind AS 115 – Revenue From Contracts with Customers

Recognition of Revenue based on the five step model acting as a single source of revenue recognition requirements for all entities in all industries

2

Ind AS 116 - Leases

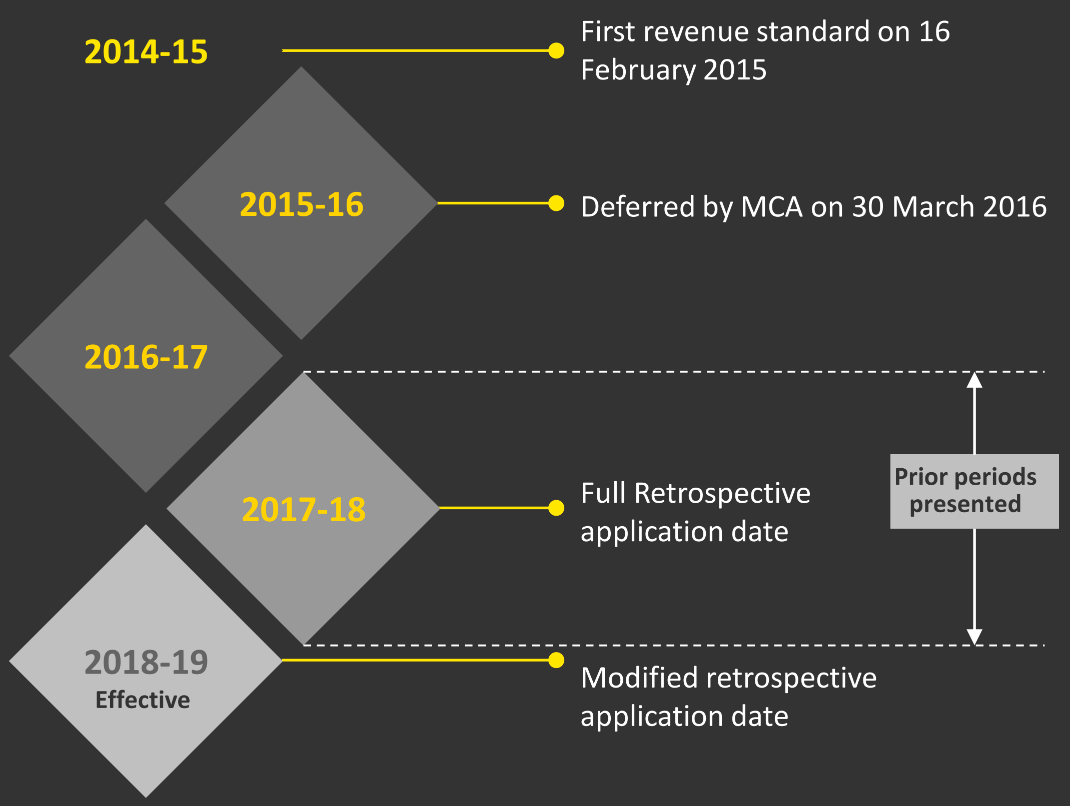
The new standard sets out a comprehensive model for identification of lease arrangements and prescribes single accounting model to be used for all leases with limited exemptions

1 Discussion on Ind AS 115

Overview

- On 28 March 2018, MCA notified that Ind AS 115 will be applicable for accounting periods beginning on or after 1 April 2018.
- It replaces all existing Ind AS revenue recognition requirements (Ind AS 11 / 18 / Guidance note on Real estate).
- Ind AS and IFRS revenue standards are substantially aligned, with some limited carve outs.
- The new framework focuses on the performance obligations in the contract and allocating a transaction price to those obligations.
- The new model is a control model, rather than a risk and reward model.

Timeline



Summary of the model

Impact

- It will be necessary to reassess contracts with customers using this five-step model, in order to understand the impact of the new standard.
- Systems and associated business processes are likely to require changes in order to achieve cost-effective compliance.

Core principle: Recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity **expects to be entitled** in exchange for those goods or services

01 Identify the contract(s) with the customer

02 Identify the performance obligations in the contract

03 Determine the transaction price

04 Allocate the transaction price to the performance obligations

05 Recognize revenue when (or as) each performance obligation is satisfied

Step-wise Practical Issues under Ind AS 115

Step 1. Identify contract
- Identification of contract
- Contract Modification
- Contract Combination

Step 2. Identify Performance obligation (PO)
- Multiple Element Arrangements (PO)
- Installation and Warranty
- Right of return
- Material Rights
- Free vouchers / Loyalty points

Step 3. Determine Transaction price
- Significant Financing Component
- Variable consideration
- Non-cash Consideration
- Implied price concessions
- Discounts and incentives

Step 4. Allocate Transaction price
- Estimating Standalone Selling Price for allocating transaction price to identified PO

Step 5. Recognition
- Timing of Recognition of Revenue – Over time or point in time
- Measure of progress – Input v/s output method

Others
- Contract Costs
- Principal vs Agent
- Presentation / Disclosures
- Transition Method
- Licenses

Practical experience - Global / Indian scenario

Global Scenario

IFRS 15 became effective globally for periods beginning from 1 January 2018

Entities mostly likely affected by Changes – Q1 and Q2 impacts

- Construction and engineering entities that enter into contracts that provide for performance obligations, allow for contract modifications or contain significant financing components.
- Retail & consumer and Pharma entities providing rights of return to customers, selling products through distributors or resellers, providing customer options for goods or services and licenses and franchising arrangements.
- Telecommunications entities selling post-paid contracts to customers impacting variable consideration

Indian Scenario

Ind AS 115 became effective in India for periods beginning from 1 April 2018

Entities affected / mostly likely affected by Changes – Q1 impacts

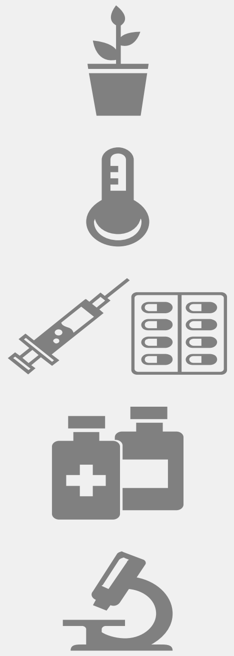
- Real Estate – Many Companies transitioned from POCM to Completed contracts method of revenue recognition like DLF, Prestige Estate Projects, Sobha Ltd
- Pharma – Many Companies did not report major impact on transition, as they transitioned using modified retrospective approach
- Retail - A large retail apparel brand "Shopper's Stop Limited" reported huge reduction in its revenue on account not meeting 'transfer of control' criteria in case of sale or return basis arrangements.

Practical experience - Implementing Ind AS 115

Implementing Ind AS 115 – Distribution Channels

Life sciences landscape: why it maybe more challenging

- Application of Ind AS 115 will require life sciences entities to use greater judgment.
- The flow of product through the supply chain of a life sciences entity triggers a wide range of commercial transactions and events which fall within the scope of Ind AS 115.
- For example, the potential for rebates and discounts will impact estimates that are required for determining the transaction price.
- These estimates will need monitoring on an ongoing basis to identify any changes to the transaction price.

Customers/payers	Products	Contract type/terms	Geography
Patients		Licences of IP	Arrangements can vary by market
Wholesalers		Collaboration agreements	
Physician		Milestones	
Specialty distributors		Cost sharing	
Hospital		Right of return	
Government agency		Variable consideration	
Pharmacists		Gross vs. net	
Competitors		Reseller/distributor arrangements	
		Outcome-based	

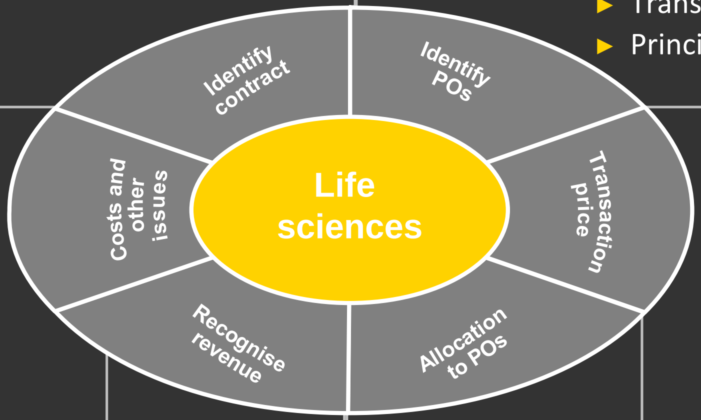
Implementing Ind AS 115 - Key Issues

Step 1: Identify the contract

- Is this a contract with a customer?
- Contracts with oral or implied terms
- Services contract or collaboration agreement?
- Contract combinations

Costs and other issues

- Contract costs: costs to obtain the contract



Step 2: Identify the POs

- Products sale contracts including services (medical devices, product or sale support)
- Co-development and co-marketing contracts
- Transportation and insurance as separate POs?
- Principal vs. agent analysis?

Step 3: Determine the transaction price

- Variable consideration (e.g., rebates, milestones, performance bonuses, right of returns) and the constraint
- Sales to distributors or resellers and consignment stock
- Financing component (e.g., long-term R&D contracts)
- Consideration paid to customers
- Will your systems and procedures enable you to identify variable consideration at contract inception?

Step 4: Allocate transaction price to POs

- Stand-alone selling price:
  - Stand-alone selling prices may not always be observable
  - Need to apply appropriate estimation method (if applicable)

Step 5: Recognise revenue

- When does control transfer?
- Licence agreements (right to access versus right to use)?
- Recognition of sales-based royalties
- Recognition of milestones payments

Practical experience - Implementing Ind AS 115

1

Identification of PO

An Indian multinational pharma company had to reverse income recognised in earlier periods in relation to "out-licensing" arrangements as it did not meet separate performance obligation criteria

2

Satisfaction of PO

Key distinction between performance obligation is satisfied – "at a point in time" or "over a period of time" – key for licensing arrangements.

3

Identification of Customer

Collaborator Vs. Customer? Is counter party sharing the risk of arrangement or only eligible to receive goods or services in lieu of consideration paid

4

Financing Arrangements

Key funding arrangement from customer or collaborator. How the same apply to transaction price determination

5

Transaction Price

Discounts, chargebacks, rebates, royalty/profit share, penalties, termination clauses, refunds, bonus, right to return and other similar arrangements are quiet normal for pharma

6

Timing of Recognition

POCM or at a point in time. Any contingency with respect to revenue earned? Any risk of significant reversal of revenue?

Transition choice - Full vs modified retrospective adoption

	PY (2017-18)	CY (2018-19)	Disclosures
Full retrospective (with optional practical expedients)	Cumulative catch-up	Contracts under new standard Contracts restated	Ind AS 115 and Ind AS 8 disclosures apply
Modified retrospective (Cumulative effect at date of application)	Contracts not restated	Cumulative catch-up Existing* and new contracts under new standard	Existing and new contracts compared using current Ind AS (e.g., Ind AS 18) in CY

***Entities may elect either to apply Ind AS 115 only to contracts that are not completed, or to all contracts, including completed contracts, at the date of initial application.**

Factors to consider while choosing the approach include:

- The number of contracts to be restated
- The length of contracts: long-term vs short-term
- The ability to obtain historical information

Next steps

What management can do now

Issues and steps	What can management do now?
Gain a general understanding of the standard	► Involve appropriate business unit and finance personnel in Ind AS 115 training sessions ► Stay abreast of latest developments from the FASB, IASB and other regulators
Perform a preliminary assessment of both the accounting and business impact of the standard	► Gather a representative (but judgemental) sample of contracts ► Analyse your commercial relationships with customers over the life cycle of these contracts ► Perform an initial analysis of the accounting rules and develop views about new accounting policy ► Identify both financial and operational risks and judgements (e.g., evaluation of performance obligation, determination of when control is transferred, assessment of the impact of rights to return, warranties and other key contractual terms) by assessing the needs of the business along the contract life cycle ► Include an assessment of necessary disclosures in the financial and operational risk assessment ► Include an assessment of current contract management capabilities in the financial and operational risk assessment ► Form a view of the impact of the accounting changes on key financial ratios and performance, indicators (e.g., gross margins) over the term of the business plan
Interact with the market to exploit both accounting and system solution developments	► Stay abreast of industry developments and amendments to the standard that may be issued by accounting standard setters ► Initiate discussion with peers on industry-specific revenue recognition issues ► Participate in both sector and generic system development to influence and exploit new solutions

2 Discussion on Ind AS 116

Overview

- IASB issued IFRS 16 in January 2016 which replaces the existing IAS 17 for financial periods beginning on or after 1 January 2019.
- ASB of ICAI issued exposure draft on Ind AS 116 Leases on July 18, 2017.
- Lessees will have a single on-balance sheet accounting model for all leases, with exemptions for short-term leases and leases of low-value assets.
- Lessor accounting is substantially unchanged.
- Lessees and lessors will have additional disclosure requirements compared to current accounting.
- The new standard could have broad implications for entities' finances, operations and EBITDA.
- Implementing the standard could require an entity to develop new processes and controls or adjust existing ones to identify and account for leases.
- New standard is expected to be effective for annual reporting periods beginning on or after 1 April 2019. Early application not permitted.

IFRS 16 to cause an impact on ~**$2.86t** off-balance sheet Leases over a sample of 14,000 listed companies – as per a study published by IASB in a publication: *'Effect Analysis IFRS 16 Leases'*

Setting the Context

Applying Ind AS 116

MCA issued a **Exposure draft on** new standard Ind AS 116 Leases. The Ind AS 116 replaced all previous accounting standard on leases Ind AS 17

Getting Ind AS 116 ready

2016

2018

- Impact assessment
- Accounting policy adoption
- Single repository for lease contracts
- Data, systems and processes' compliant
- Reporting and disclosure requirements
- Development of lease strategy
- Start Leases comparative period

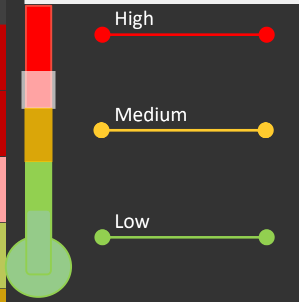
2019

- Effective date of implementation- 1 April 2019
- Post migration monitoring
- Keeping update with Ind AS 116

Ind AS 116 - Sector Impact

Sector	Level of impact	Effort to comply
Telecom	H	H
Banking	M	H
Retail	H	H
Mining	H	M
Oil and Gas	M	M
Construction	L	M
Insurance	M	L

Heat map



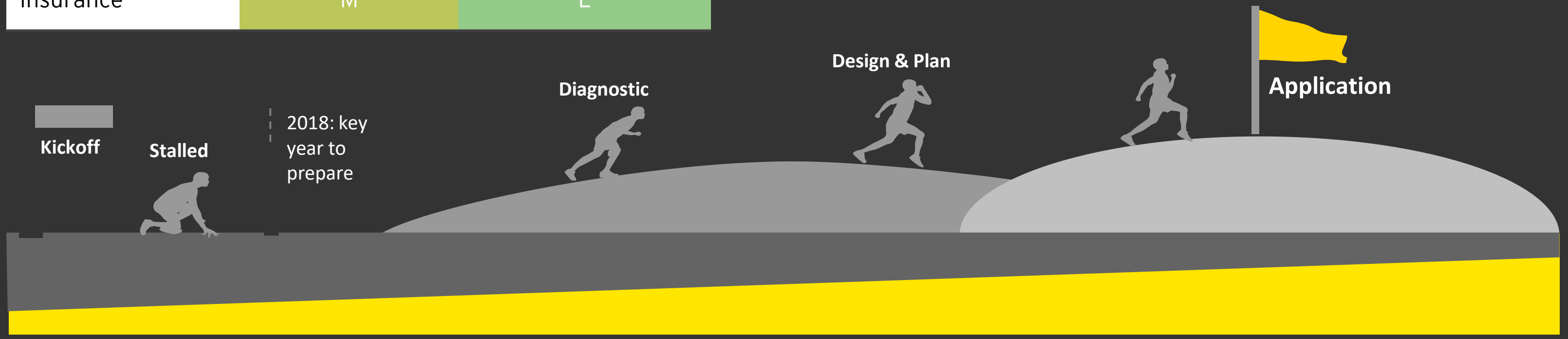
IFRS 116 to cause an impact on ~$2.86t off-balance sheet Leases over a sample of 14,000 listed companies

Average companies spend ~$1m-$3m, equivalent to ~0.02% of their Lease exposure

Percentage of IFRS/US GAAP listed companies that disclose off-balance sheet Leases[1]

Asia Pacific	43%	North America	62%	Africa/ Middle East	23%
		Latin America	23%	Europe	47%

Note: As per a study on Ind AS 116 effects by IASB



Setting the Context

Applying Ind AS 116

MAC issued a new standard Ind AS 116 Leases. The Ind AS 116 replaced all previous accounting standard on leases Ind AS 17.

What is Ind AS 116?

New Leases standard by MCA

Effective **1** April 2019

Early application not permitted

Understanding Ind AS 116

Recognise assets and liabilities for most Leases that may currently account for as Operating Leases:

Property (land, office building, store etc.)
Plant and equipment (vehicle, IT assets)
Office equipment

Lessees permitted to chose transition period:

- Full retrospective; or
- Modified retrospective

Need to review all contracts to identify the impact areas

Identifying Lease contracts

Is there an identified asset? [2] — No → The contract does not represent or contain a Lease

Yes

Does the customer have right to obtain substantially all economic benefits from the use of identified asset throughout the period of use? — No → The contract does not represent or contain a Lease

Yes

Does the customer or supplier have right to direct, how and for what purpose the identified asset is used throughout the period of use? — Customer → The contract represents or contains a Lease; Supplier → The contract does not represent or contain a Lease

Neither; how and what purpose is predetermined

Does the customer have right to operate the asset throughout the period of use, without the supplier having the right to change those operating instructions? — Yes → The contract represents or contains a Lease

No

Did the customer design the asset (or specific aspects of the asset) in a way that predetermines how and for what purpose the asset will be used throughout the period of use? — Yes → The contract represents or contains a Lease; No → The contract does not represent or contain a Lease

The contract **represents or contains** a Lease

The contract **does not represent or contain** a Lease

Key Judgements and estimates

- Is it a lease?
- Are there non-lease components in the contract?
- Should the practical expedient for short-term leases be considered?
- What is the lease term, considering renewal, termination and purchase options?
- Are there variable lease payments and residual value guarantees?
- What is the lease classification?
- What is the discount rate?
- Does the transaction qualify for sale-leaseback accounting?
- Which transition approach to be adopted in IFRS – full retrospective or modified retrospective?

Recognition and measurement

- A lessee applies a single lease accounting model under which it recognises all major leases on-balance sheet

Balance sheet	Profit and Loss
Asset **= 'Right-of-use' of underlying asset** **Liability** **= Obligation to make lease payments**	**Lease expense** **= Depreciation + Interest**

Consider exemptions - Short-term lease and lease of low-value assets

Lessee accounting: Initial measurement – ROU

Lease liability

+

Initial direct costs

+

Estimated costs to dismantle, remove or restore, measured In accordance with Ind AS 37

+

Prepaid lease payments (eg. Deposit)

−

Lease incentives Received

=

Right-of-use-asset

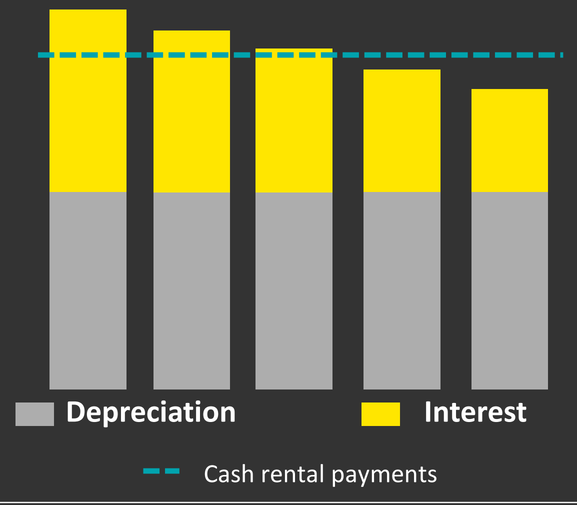
Impact on financials

Impact on balance sheet

- Companies with operating leases will appear to be more asset-rich, but also more heavily indebted

Impact on statement of profit and loss

- Total lease expense will be front-loaded even when cash rentals are constant



Impact on financials ratios

	Profit/loss	Balance sheet	Ratios
↑	EBITDA	Total assets	Gearing
↓	EPS (in early years)	Net assets	Interest cover

Practical Implementation Issues

Practical Implementation Issues

1

Non-lease components

Separate non-lease components (e.g. services)

Practical expedient (policy) – account all as a lease

2

Combining contracts

Negotiated as packaged with single objective OR

Price of contract depends on price / performance of another

3

Sub leases

Generally treated as two leases unless meet contract combination requirements

4

Measuring variable payments

Lessee shall include variable payments as part of lease liability

Lessor shall include variable payments as part of rental income

5

Intra-group leases

To be evaluated for standalone financial statements

6

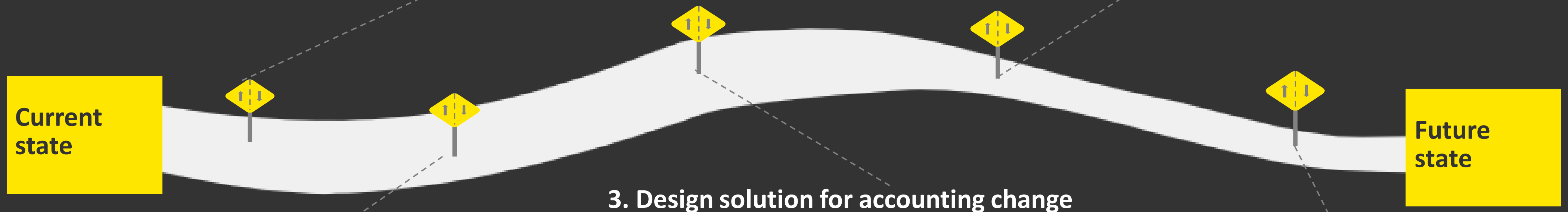
Initial Direct Costs

To be included as part of the right of use asset and

Lease implementation journey

1. Understand current state of leasing and revenue activities
(e.g., lease procurement, revenue contracts administration, and accounting and reporting)

4. Implement new accounting policies, processes, controls and systems, as well as changes to financial statements and disclosures



3. Design solution for accounting change

(e.g., new accounting policies, processes, controls and systems) to capture new lease data requirements and understand financial statement impact

2. Identify changes resulting from the new standards
(e.g., data gaps, processes, controls, systems and tax)

5. Transition to the new standards for both leases and revenue recognition

Key Disclosures - Lessee

Quantitative disclosures

Income statement

- Amortization expense for right-of-use assets
- Short-term lease expense
- Small ticket lease expense
- Variable lease expense
- Interest on lease liabilities
- Income from subleases
- Sale and lease back

Balance sheet

- Maturity analysis of lease liabilities
- Carrying amount of right-of-use assets (by class)

Financial Statements

Cash flow statement

- Cash outflow for leases
- Additions to right-of-use assets

Qualitative disclosures

- Nature of lessee's leasing activities
- Future cash outflows to which the lessee is potentially exposed that are not reflected in the measurement of liabilities:
  - Variable lease payments
  - Extension and termination options
  - Residual value guarantees
  - Leases not yet commenced which the lessee is committed
- Restrictions or covenants imposed by leases
- Sale and lease back transactions

Transition date – Retrospective Vs Modified approach option

Lessees are permitted to choose between two transition approaches applied consistently to all leases

- Full retrospective
- Modified retrospective

Retrospective application or modified approach?

Option 1 – Retrospective

Restate comparatives as if Ind AS 116 always applied

Option 2 – Modified (Do not change comparative FS)

Difference between asset and liability recognised in opening RE at transition date.

Operating Leases:

Calculate present value of remaining lease payments for existing operating leases using incremental borrowing rate at date of transition.

Choose how to measure ROU asset on **lease-by-lease basis:**

Option 2A –

- Measure asset as if Ind AS 116 had been applied from lease commencement (but using incremental borrowing rate at date of transition)

Option 2B –

- Measure asset at amount equal to liability (adjusted for accruals and prepayments)

Thank you

CA Jalpa Sonchhatra
Jalpa.Sonchhatra@in.ey.com