Ind AS Transition
Challenges & Key takeaways

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Ind AS Implementation: A Giant Leap

- Step in the right direction
- Substantial improvement in accounting
  - Financial instruments
  - Business combinations
- Enhanced transparency and accountability
  - Critical judgements and estimates
  - Presentation & Disclosure
  - Financial risk management

Achieving consistency and quality in Ind AS implementation is expected to take few years.

A roller-coaster ride

- Transition was not a smooth process
  - Use of excel sheets, instead of system driven process
  - Fixed asset register not updated
  - Impact on internal financial controls not considered
- Finding sweet-spot is not easy
  - Companies are working till last minute to finalize accounting policy choices/ exemptions
  - MAT clarity came too late
- All key stakeholders are not aligned!

Shifting goal post
Government grant

- Under Indian GAAP, the company has netted government grant from the cost of PPE
- On transition to Ind AS, the company is using previous GAAP carrying amount as deemed cost exemption for PPE
- Ind AS 20 requires government grant to be treated as deferred income – No option to reduce from cost of PPE

Original ITFG decision (Dated 3 October 2016)

- No adjustment is allowed to carrying amount of PPE
- For applying Ind AS 20 retrospectively, corresponding debit should be made to retained earning.

Revised ITFG decision (Dated 17 April 2017)

- Adjustment to PPE is only consequential and arising due to other transition requirements of Ind AS 101
- Deferred grant should be adjusted to the deemed cost of PPE

Shifting goal post
Classification of deposits

Classification of security deposits received by an electricity company from its customers

Original ITFG decision (Dated 3 October 2016)

- No unconditional right to defer refund of deposit for 12 months
- Expectation of the company are not relevant for classification
- The security deposits should be classified as a current liability

Revised Position

- ITFG has withdrawn the above decision on 17 April 2017
- One may argue that electricity and similar companies, e.g., a company providing gas or water supply, will classify deposits received from the customers as current or non-current liability based on estimated redemption pattern
- View will apply in limited circumstances such as in monopolistic or oligopolistic situations where choices available to the consumer to change the service provider are highly limited
- View will not apply by analogy in all cases – e.g. in the case of security deposit received a consumer goods company from retailers/ distributors – classification would continue to be current.
- Recognition and measurement is governed by Ind AS 109. Consequently, no discounting is required

Shifting goal post
Previous GAAP carrying amount as deemed cost

- A first-time adopter may opt to use previous GAAP carrying amount of PPE as deemed cost at transition date
  - Needs to be applied to all items of PPE – No pick and chose allowed
  - In CFS, option need to be applied at group level
  - If a company uses this option, only adjustment allowed to previous GAAP carrying value is for decommissioning liabilities. No other adjustment allowed.
  - Option can also be used for intangible assets and investment property.

Proposed recent change

  - Carrying value can be taken as the deemed cost for ‘a class’ of assets instead of ‘all’ assets on the transition
  - When the company chooses to adopt the previous GAAP carrying value as at the TD to Ind AS, consequential changes arising on application of other Ind AS can be made to the deemed cost of PPE

This may potentially help phase 2 companies with effect from 1 April 2017.
Whether phase 1 companies can also benefit!

Ind AS impact

BSE 100 CFS

(Amount in INR crore)

Net Worth

↑ 1,64,500

↑ 2,03,683	↓ 39,183
• Reversal of proposed dividend • Fair valuation of PPE • Fair valuation of Investments • Reduction in debt due to equity method of accounting for joint ventures	• Reclassification from equity to liability • Impairment loss on financial assets • Fair valuation of PPE

(Amount in INR crore)

Debt

↓ 72,593

↑ 22,073	↓ 95,026
• Presentation of the substance of the commercial arrangements i.e., equity to liability classification	• Equity method of accounting for joint ventures

- Very few companies have used the FV option that increased net worth
  - 3 companies have fair valued their investment in group companies
  - 7 companies have fair valued their PPE

Ind AS impact

BSE 100 CFS

(Amount in INR crore)

Revenue

↑ 1,56,490

↑ 2,14,359	↓ 57,869
• Grossing up of excise duty	• Recognition of revenue at fair value with adjustment for discount, incentives, rebate

(Amount in INR crore)

PAT

↓ 4,436

↑ 10,988	↓ 15,424
• Investments at FVTPL • Capitalization of spares at PPE • Reclassification of government grant to P&L, which were credited to capital reserve	• ESOPs at fair value • ECL on financial assets • Borrowings at EIR • Fair valuation of PPE, but it will increase depreciation for subsequent years

Industry Related Challenges

Legal/ regulatory aspects
Insurance JV

- Many Indian companies have set-up insurance companies in partnership with foreign partners
- Insurance Laws (Amendment) Act, 2015 specific safeguards related to Indian ownership and control (FDI allowed upto 49%)
- Foreign partner has effective control or joint control
- Under Indian GAAP, Indian partner accounted for Insurance company as its subsidiary, based on 51% shareholding
- Under Ind AS, insurance company no longer a subsidiary
- Shareholders agreements changed to enforce IRDA’s requirement of ‘India Owned India Controlled’ concept

Service concession arrangements

Indian GAAP		Ind AS	
PPE	100	Construction cost	100
		Construction margin/ profit	20
		Construction revenue	120
		Intangible Asset or Receivables	120

- Revenue sharing implications
- MAT and tax implications on construction profit
- If financial assets model applies, the company may become an NBFC

Arrangement containing lease
Appendix C Ind AS 17

Determining whether an arrangement is, or contains, a lease

Fulfilment is dependent on the use of a specific asset	Arrangement conveys right to use the asset

Structuring possibilities

- Multiple plants used interchangeably
- Multiple customers – Single customer does not take more than 85/ 90% of output
- Lease is an operating lease (particularly leases between holding and subsidiary)
- Law overrides accounting requirements

Ind AS 111 – Impact on an Indian Tower Company

- Under Indian GAAP, joint ventures are consolidated using proportionate consolidation method.
- Ind AS requires equity method of accounting

Impact on Indian Tower company

Impact on results of FY March 2016	INR million	%
Reduction in revenues	Approx. 68,000	More than 50% reduction
Reduction in PPE	Approx. 79,000	57% reduction
Reduction in gross assets	Approx. 38,000	15% reduction

Based on CODM reporting, the company presented segment information using proportionate consolidation method.

This helped the company to present proportionate consolidation numbers in the financial results.

Unfinished Agenda
Regulations not yet Aligned !!

- Telecom companies are required to pay license fees on their revenue
- As per the Hon'ble Supreme Court judgement, revenue includes treasury income
- Under Ind AS, income will increase due to:
  - Interest unwinding on loan to subsidiary
  - Unwinding of financial guarantee obligation
  - Fair value measurement of mutual fund investments
- Regulators may argue that telecom companies are required to pay license fee on such income

Interaction of Ind AS & MAT: interest free loan to subsidiary

A day prior to transition, Parent gives 10 year INR 1000 interest free loan to Subsidiary

Parent accounting	Debit	Credit
On transition date		
Loan to Sub.	600	
Investment in Sub	400	
Bank		1000
Going forward over 10 years		
Loan to Sub.	400	
Interest income (P&L)		400
(unwinding of interest on loan)		

MAT Implications

Benefit available on sale/ realization of investment in subsidiary

It will form part of book profits over the years of income recognition

Business Combination: slump sale transaction

Parent acquires business under slump sale before transition date from subsidiary

Scenario under Indian GAAP: Apply acquisition accounting under AS 14

Particulars	INR
Consideration	1000
Book value/ fair value	600
Goodwill	400

Scenario under Ind AS: Common control transaction. No acquisition accounting. No goodwill.

Particulars	INR
Consideration	1000
Book value	600
Capital reserve (negative)	400

Normal Income tax Computation

- Goodwill forms part of gross block of asset for tax purposes
- Depreciation benefits subject to certain conditions

MAT implication under different Ind AS scenario

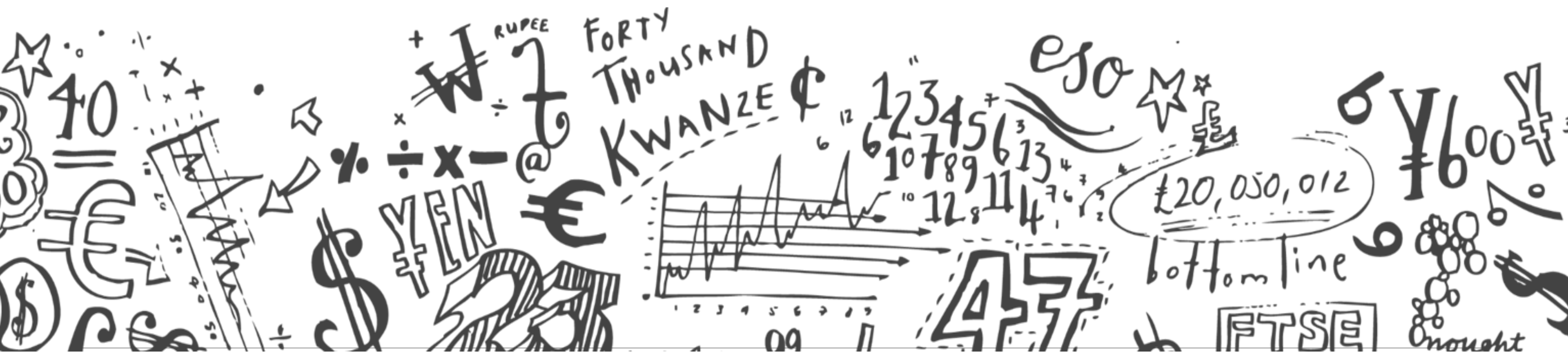
- Ind AS 103 applied retrospective:
  - Capital reserve (negative) is not MAT deductible
- Ind AS 103 applied prospectively
  - Goodwill not MAT deductible since amortization not permitted under Ind AS

Financial Instruments

Debt vs. equity classification under Ind AS

Financial statements of the issuer

- Key criteria for equity classification:
  - **No contractual obligation to deliver cash** or another financial asset
  - Exchange of fixed amount of cash for fixed number of **equity instruments** (fixed-for-fixed criterion)



Convertible preference shares

Scenario

	1	2	3
Facts	No obligation to redeem CPS CPS are compulsorily convertible No. of equity shares to be issued on conversion is fixed upfront	Issuer obligation to redeem the CPS, if it fails to achieve qualified IPO within 5 years from the date of issue If converted, no. of equity shares to be issued on conversion is fixed upfront	Issuer has no obligation to redeem CPS CPS are compulsorily convertible No. of equity shares to be issued on conversion is variable Calculated by dividing liability amount with fair value of shares at conversion date
Classification	**Equity:** Meets criteria for classification as equity	**Compound FI**: Successful IPO not within control – No unconditional right to avoid paying cash	**Liability**: No. of shares to be issued on conversion is variable

Debt vs. equity classification issues

Perpetual bonds

- Non-redeemable but callable at the issuer’s option
- Issuer’s option to defer interest in perpetuity
- Dividend on equity shares cannot be paid without paying interest
- Interest rate increases if bonds not redeemed within specified period

Classification

- No contractual obligation to pay cash
- Classification as equity
- Interest is treated as dividend

Factoring/ bill discounting

- The entity has a current debtor portfolio of INR 100 crores. It enters into a factoring arrangement with the bank
- Consider the following three scenario's

Variability pre transfer	Bank recourse	Derecognition?
INR lakh		**Yes or no**
100	100	No
100	0	Yes
1	1	No

Structuring possibilities

- Credit insurance
- Sale of receivables to SPV
- Restructure pricing and transfer variability to bank

Debt covenants

Example

- ABC has taken a long-term loan from bank
- The loan agreement requires ABC to comply with target Debt-equity ratio at year-end (31 March). Ratio is a very important debt covenant.
- Ratio not met at 31 March
- Current classification applies
- How does one wriggle out of this problem?

Fair valuation of equity instruments

Unquoted equity instruments

- Media company having significant unquoted investments
- Changes in agreement with investee to provide timely information
- Valuation professionals involvement

Holding in parent of large conglomerates/ intra-group holdings

- Parent valuation may require fair valuation of all group entities
- Co-ordination among group entities to avoid multiple valuations

Subsidiaries/ associates/ joint ventures

- Equity investment may be measured at cost or fair value
- Other investments, e.g., OCDs (Optionally convertible debentures), will require fair valuation

A company from the extractive industry reported an impact of INR 4,188 crore on the net worth as on 31 March 2016 due to fair valuation of financial assets.

Thank you