

Accounting issues related to Pharma Industry

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Why talk about Pharma Industry

- Importance of medicines in modern day life
- Increased life expectancy and dependency on medicines
- Size of Industry
- Number of Pharma Companies
- Complex operations and consequent complications in accounting
- Increased opportunities for accounting profession

Types of Pharma Enterprises

Manufacturers -

Bulk Drugs

Formulations

Loan Licensee

Others -

R & D Services, Validation Services

Marketing Companies

Companies carrying out Clinical Trials

Important Issues in accounting

- Research and Development
- Life of Patents and Trademarks
- Marketing Tie-ups and Royalties
- Discounts and Rebates
- Impairment of Assets
- Valuation of Inventory
- Segment Reporting
- Consolidation of Financials
- Business Combinations



Research and
Development

Expenditure on R&D

Average expenditure on R&D by Indian Companies

5 - 10 % of annual turnover

Value of internally generated Intangible Assets

miniscule.... Reason?

AS26 – Fulfillment of stringent conditions of “Development Phase” and provisions regarding Internally generated goodwill and expenditure already charged to revenue

Another reason is generic nature of Indian Pharma Industry

Many other Indian Pharma Companies **carry out research** for their foreign parent or other Companies

Different Aspects

Research Phase

Development Phase

Basic Research

Bio-batches

Clinical Trials (Human and others)

Goodwill arising from acquisition (Valuation of Pharma Company results in goodwill since all the research costs get charged to revenue)

Definition in AS 26

6.1 An intangible asset is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.

6.2 An asset is a resource:

- (a) controlled by an enterprise as a result of past events;
and**
- (b) from which future economic benefits are expected to
flow to the enterprise.**

Important Criteria

Identifiability

Control

Future Economic Benefits

Additional Criterion

- (a) the technical feasibility of completing the intangible asset so that it will be available for use or sale;
- (b) its intention to complete the intangible asset and use or sell it;
- (c) **its ability to use** or sell the intangible asset.
(usually dependent on regulatory approval)
- (d) how the intangible asset will generate probable future economic benefits. Among other things, the enterprise should demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset;
- (e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and
- (f) its ability to measure the expenditure attributable to the intangible asset during its development reliably.

Different Aspects of AS 26

Clause 50 of AS26 states that internally generated brands should not be recognised as intangible assets as they cannot be distinguished from the cost of developing the business as a whole

Clause 58 of AS 26 states that expenditure already recognised in earlier financial years should not be reversed and added to the cost of Intangible Asset

Marketing and related costs not included

Phase IV exp needs to be justified by super profits

Impairment of Assets- specially for assets not yet available for use and those amortised over more than 10 years

Intangible Assets

Particulars	Indian GAAP	IFRS
Revaluation	<u>AS26:</u> Not Permitted.	<u>IAS38:</u> Permitted for intangibles with active markets.
Intangibles with indefinite life	Not specifically mentioned. Amortisation required	No amortisation, only impairment required.
Amortisation	10 years rebuttable presumption.	No such presumption.
Impairment testing	To be tested even when no indicators exist for the following assets: a) Assets not available for use b) Assets amortised > 10 years	No testing if no indicators, except for the following assets: a) Assets not available for use b) Assets having indefinite useful life

Intangible Assets

Particulars	Indian GAAP	IFRS
Biological Assets	<u>AS26:</u> No comprehensive guidance	<u>IAS38:</u> Measured at fair value less estimated point of sale costs. Revalued periodically

Inventory

- Channel Stuffing
- Sales to CNF Distributors or Consignment Sales
- Physical count –
 - Periodicity
 - Barter Exchange
- Valuation –
 - Expired batches
 - Batches nearing expiry so that they cannot be sold in the market
- Inventory of Packing Material and Physician's Samples

Impairment of Assets

Impairment of Intangible Assets:

Impairment of patents, trademarks, know-how, marketing tie ups, goodwill etc.

Management plans & estimates play an important role.

Plans & Estimates are subject to frequent changes

Segment Reporting

- Geographical segments

 - Exports (Country or Regionwise?)

 - Domestic (Statewise ?)

- Business Segments

 - Bulk Drugs

 - Formulations

 - R&D and Clinical Trials and Other Services

 - Trading

 - Based on types of Customers

Other Accounting Issues

- Withdrawal of Guidance Note on “Treatment of Expenditure During Construction Period”
- Deferred Tax Liability
- Accounting for MAT
- AS-30 Vs. Announcements by ICAI for Revaluation of Derivatives and Notification issued by Government
- Component Accounting of Fixed Assets

Recent Trends

Spinning off R&D Units

Huge cash locked in investments
Delisting of subsidiary companies

- Acquisition of companies (in many cases, bigger than the parent- Reverse Merger)
- Cash crunch due to aggressive business decisions

Off Patent products
Abbreviated New Drug Applications (ANDA)

THANK YOU

