Ind AS Conversion
Issues, Challenges and Techniques

WIRC – 4TH February 2017

TECHNICAL ASPECTS

- Total emphasis on FAIR VALUE measurement
- Debt (financial liability) VS Equity
- Retrospective application / re-statement
- Other Comprehensive Income items
- Statement of changes in Equity
- Effective interest Rate (EIR) method for finance cost / interest income
- Deferred Tax calculation – balance sheet liability method

What are we covering in this session

- Tangible Assets – Ind AS 16 / 40 / 105
- Revenue recognition – Ind AS 18
- Effects of changes in foreign exchange rates – Ind AS 21
- Financial instruments – recognition, classification, measurement
  - Distinction between Equity AND Financial Liability – Ind AS 32
  - Financial assets and financial liabilities – classification and measurement – Ind AS 109

Tangible Assets

Ind AS 16 / Ind AS 40 / Ind AS 105

Tangible assets – Property Plant and Equipment

- Two new classes – Investment Property & Non Current Assets Held for Sale
- Deferred payment terms on acquisition of assets
- Component accounting
- Initial estimate of dismantling costs added to the cost of the asset on initial recognition *(Example 1)*
- **Date of Transition:**
- Carrying value as Deemed cost on date of transition to Ind AS (Ind AS 101)
- Recognition of dismantling costs in the carrying value as on transition date *(Example 2)*
- Component accounting

Investment Property

- Property means land or building or both land and building
- Investment property means property held for rentals or for capital appreciation
- Classification as owner occupied (Ind AS 16) and Investment property (Ind AS 40)
- Investment property – only the cost model is permitted
- Dual purpose property
  - ✓ If Separable → split accounting
  - ✓ If NOT separable → classification based on which component is significant

Investment Property

- Ancillary services provided in case of property given on rent to others
  - ✓ If ancillary services insignificant → property is Investment property *(Example 3)*
- Active Vs passive investor in case of let out property
  - ✓ Investor involved in day to day operations affecting cash flows → Owner Occupied property (PPE) Ind AS 16 *(Example 4)*
- Classification in case group situations – property let out by a holding company to its subsidiary
- **<u>On transition date:</u> option to have** carrying amount to be Deemed cost of the investment property as on date of transition

Non Current Assets being held for sale

- The asset must be available for immediate sale in its present condition

- Its sale must be highly probable - criteria

  management commitment

  active program to locate buyer

  sale within one year

  actively marketing strategy

  no significant changes to sale plan

- On classification date, measured at lower of Carrying amount and Fair Value *less* costs to sell

- Depreciation ceases on the date of classification as being held for sale

Non Current Assets being held for sale

- Such a Non current asset can either be an individual asset or a group of assets (disposal group / CGU)

- Determine fair value at each reporting period – increase or decrease in accordance with Ind AS 16 *(Example 5)*

- Changes to sale plan

✓ If classified for sale is Individual asset / disposal group → re-measure at lower of its cost less depreciation(as if the asset had never been so classified) and recoverable amount

✓ If classified for sale is a subsidiary, associate or joint venture → retrospective application

✓ Commence depreciation thereafter

REVENUE

Ind AS 18

Revenue Recognition

- Revenue at fair value of consideration received or receivable
- Revenue in case of Deferred payment terms
- Revenue in case of sale of goods – passing of risks and rewards of ownership
- Revenue in case of rendering of services – percentage completion method only
- Interest income using the effective interest rate method *(Example 6)*
- Customer loyalty program – split accounting at initial recognition *(Example 7)*

INCOME TAX – Deferred tax

Ind AS 12

Deferred Tax – Ind AS 12

- Tax base of assets and liabilities
- Concept of Temporary differences = carrying amount of an asset / liability (-) its tax base
- Deductible temporary differences → leading to reduction in future taxable profits – deferred tax asset
- Taxable temporary differences → leading to increase in future taxable profits – deferred tax liabilities
- No concept of a permanent difference
- Current tax and deferred tax recognised outside profit and loss account
- Apply Ind AS 12 on date of transition – no Exemption in Ind AS 101

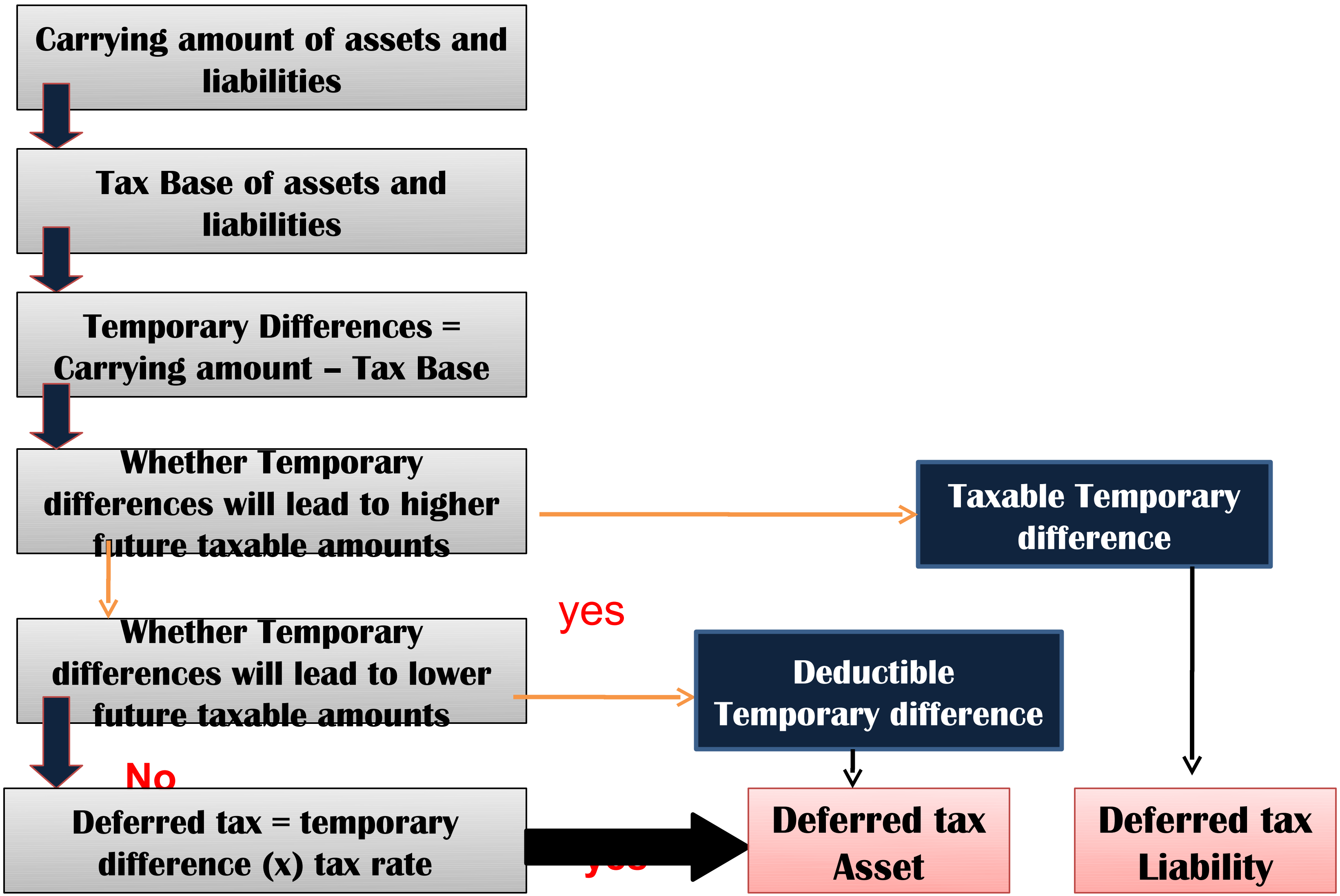
Deferred Tax - Ind AS 12

<u>What are now covered under Temporary differences ?</u>

- Timing differences
- Fair value of assets and liabilities acquired in a business combination
- Revaluation of assets – tax base is not adjusted
- Effect of indexation available in case of assets under tax laws but not available in accounting
- Goodwill arising in case of a business combination

<u>In principle we need to compare all items of assets and liabilities to analyse for any tax consequences in the future related to those assets and liabilities</u>

DEFERRED Tax - STEPS



Deferred tax calculation

	IF (CA – TB)	Result	DTA / DTL
Asset	+ ve	Taxable TD	DTL
Asset	- ve	Deductible TD	DTA
Liability	+ ve	Deductible TD	DTA
Liability	- ve	Taxable TD	DTL

- **Deferred tax =** **Taxable / Deductible temporary difference** **X** **Tax rate**

In case of unused tax losses and tax credits that have been carried forward

Deferred tax = **Unused tax loses / tax credits** **X** **Tax rate**

Foreign Exchange rates

Ind AS 21

Changes in Foreign exchange rates – Ind AS 21

- Concept of functional currency
- All entities translate foreign currency transactions into its functional currency
- Functional currency is not a matter of choice
- No concept of a group functional currency – generally it is the presentation currency of the parent entity
- In case of a foreign operation, there is no concept of an integral or a non integral foreign operation
- All foreign operations must prepare financial statements in its own functional currency before translating them in the presentation currency of the parent for consolidation

Changes in Foreign exchange rates – Ind AS 21

- Exchange differences on
  - Conversion to functional currency → recognised in Profit and loss
  - On translation of financial statements of a foreign operation → recognised in Other Comprehensive Income
- Exchange differences arising on upward revaluation of a foreign currency non monetary asset → recognised in OCI
- **First time Adoption:**
  - ✓ **Long term Foreign Currency Monetary** Item existing on transition date → continue with the policy adopted as per previous GAAP
  - ✓ **Amounts lying in Foreign Currency translation reserve (FCTR)** on transition date → transfer to retained earnings and make it 'Zero"

Financial Instruments

Ind AS 32 / 109

Financial instruments – Classification

- Classification of financial instruments based on substance and not on their legal form – i.e. financial assets, financial liabilities and Equity
- Financial instruments involves a contractual arrangement
- Measurement always at ***Fair Value on initial recognition***
- In case of convertible instruments classification between Debt (financial liability) and Equity requires careful analysis
- In case of compound financial instrument – split accounting at initial recognition into equity and liability components *(Example 8)*
- Some practical illustrations

Financial asset VS Financial liability

FINANCIAL ASSET is any asset that is	FINANCIAL LIABIILTY
Cash	-
An equity instrument of another entity	-
Contractual right to receive **cash** or another financial asset **from** another entity	Contractual obligation to deliver cash or another financial asset to another entity
Non derivative Contract for which entity is obliged to receive a variable number of the entity's own equity instruments	**Non derivative contract** for which entity is obliged to deliver a variable number of the entity's own equity instruments

- **EQUITY – RESIDUAL CATEGORY** both the following conditions are met:

(1) The instrument includes no contractual obligation to deliver cash or another financial asset to another entity; AND

(2) The instrument may be settled in the issuer's own equity instruments and it is

- **a non derivative instrument** that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; OR

Classification of DEBT (financial liability) and EQUITY

Contract settled in own equity shares	Monetary value of Consideration	Number of equity shares	Classification
Scenario 1	Fixed	Variable	Financial Liability
Scenario 2	Variable	Variable	Financial Liability
Scenario 3	Variable	Fixed	Financial Liability
Scenario 5	Fixed	Fixed	Equity

Whether or not the following are financial instruments

Trade receivables / Payables	
Loans given / accepted	
Prepaid expenses	
Cash deposited in bank	
Gold deposited in bank	
Deferred revenue / revenue received in advance	
Statutory liabilities	
Fixed assets	
Investment in subsidiary, associate or a joint venture	

Classification – Financial liability or Equity

Instrument	Classification	Reason
Compulsory convertible bonds – conversion to equity shares dependent on the FV of shares on conversion date		
In above, the Conversion ratio is fixed at the time issuance of bonds		
Instrument that will be settled by entity delivering either cash of Rs 50000 or its own shares having a fair value or Rs 75000		
A contract to deliver as many of the entity's own equity instruments as are equal in value to Rs 100		
A perpetual bond		

Classification – Financial liability or Equity

Instrument	Classification	Reason
A contract to deliver 100 of its own equity instruments in return for an amount of cash calculated to equal the value of 100 ounces of gold		
Convertible preference shares at a future date for a fixed amount and a fixed number of equity shares		
Mandatorily redeemable preference shares with a fixed redemption amount		
A written call option that allows to purchase a fixed number of equity shares for a fixed amount of cash		

- Classification of financial instruments based on substance and not on their legal form

Financial Asset	Financial Liabilities
At amortised cost (using EIR)	At Amortised cost
At Fair Value Through OCI (FVTOCI)	-
At Fair Value Through PL (FVTPL) residual category / for correcting an accounting mismatch	At Fair Value Through PL (FVTPL) residual category / for correcting an accounting mismatch

- On date of transition all financial assets and financial liabilities to be measured at fair value based on facts and circumstances that exist on acquisition date

- Reclassification of financial assets from one category to another permitted – not permitted in case of a financial liability

Financial Assets & Financial liabilities – Classification

Financial Asset	Classification
Investment in Equity instruments	Either at Fair Value through OCI or at Fair Value through P&L ✓ Fair value changes in OCI or P&L respectively ✓ Dividend always in profit and loss ✓ in case of equity instruments at FVTOCI, no reclassification of fair value changes previously recognised in OCI to profit and loss, on disposal
Investment in Equity instruments held for trading	At Fair Value through Profit and Loss only
Investment in Subsidiary, Associate, Joint Venture	At Fair value through OCI FVTOCI
Investment in Bonds, Debentures	Either at FVTOCI or at FVTPL

Financial Assets & Financial liabilities – Classification

Complications involved in accounting for financial instruments

- ✓ Loans taken / given involving significant initial transaction costs *(Example 9)*
- ✓ Loans to employees at concessional rates or free of cost *(Example 10)*
- ✓ Financial guarantee given to banks by parent company on behalf of subsidiary company or vice versa
- ✓ Bills received from customers discounted with banks
- ✓ Interest free security deposits given / taken